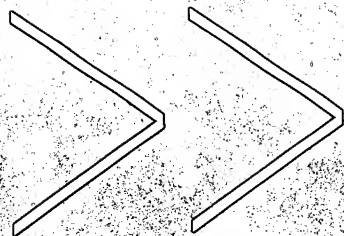

J. C. Penney Company, Inc.



CHANGE

1999 Annual Report

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Financial Overview

<i>(in millions except per share data)</i>	1999	1998	1997	1996	1995
Total revenue	\$32,510	\$30,461	\$30,410	\$23,292	\$21,084
Net income	336	594	566	565	838
Total segment EBITDA⁽¹⁾	1,694	2,159	2,449	1,974	1,923
Per common share					
Net income - diluted	\$1.16	\$2.19	\$2.10	\$2.25	\$3.33
Equity	26.07	26.74	27.31	24.71	24.60
Dividends	1.92	2.18	2.14	2.08	1.92
Debt to capital percent	54.5%	62.1%⁽²⁾	60.7%	60.3%⁽³⁾	52.9%
Retail square footage					
Department stores	116.4	116.0	118.4	117.2	114.3
Eckerd drugstores	29.2	27.6	27.4	26.4	6.2

(1) Earnings before interest, income taxes, depreciation, and amortization. EBITDA includes finance revenues, net of credit operating costs, and bad debt. EBITDA is provided as an alternative assessment of operating performance and is not intended to be a substitute for GAAP measurements. Calculations may vary for other companies.

(2) Assumed completion of the acquisition of Genovese Drugstores, Inc.

(3) Assumed completion of the acquisition of Eckerd Corporation.

Fellow Stockholders,

Our retail business underperformed in 1999. Department stores and catalog did not perform to expectations, particularly in the all-important fourth quarter. Our Eckerd drugstore business achieved sales gains, but those sales didn't translate into increased profits. Your questions, of course, are: "What are you doing about it?" and "When will we see the benefits of your actions?"

Actions Speak Louder Than Words

In 1999, we took a number of key steps to improve future stockholder value and operating results. While the market hasn't yet rewarded our stock for our efforts, their impact on future periods should be significant. These efforts included:

- A major overhaul of our department store merchandising process, focusing on delivering a compelling offering to our target customers. Our new merchandising process and organization will provide for one fully integrated plan including financial deliverables, merchandise assortments, store performance, and marketing. It will enable us to manage the business in a more timely way with focused, edited, market-right assortments. We will become more of a selling organization with a much clearer focus on serving the needs of our customers and, in turn, expect to achieve improvements in sales, margins, inventory turns, and operating profits.
- A \$530 million restructuring plan designed to improve department store and drugstore performance. Key elements include closing department stores that have not produced acceptable rates of return and do not fit within our long-term strategy. This action will improve cash flow, provide EVA benefits, and allow us to redeploy capital to improve the shopping environment of our other department stores.

We are closing 289 underperforming Eckerd drugstores for which our relocation program was not an option. We expect the closings to increase operating profit by \$20 million annually.

We have launched an aggressive campaign to lower operating costs enterprisewide by consolidating functions throughout the organization and are aggressively pursuing other programs to accelerate enterprisewide synergy benefits. These initiatives are expected to generate approximately \$55 million in savings in 2000, which on an annualized basis amounts to \$120 million. Finally, we have identified enterprisewide procurement initiatives that we expect will generate savings in excess of \$200 million — annually — when fully implemented over the next several years.

- Capitalizing upon the power of the JCPenney brand by leveraging our department store and catalog customer service operation and fulfillment capabilities to be a major e-commerce retailer. Our successful jcpenney.com, which lists more than 200,000 items, had sales in 1999 of \$102 million — an increase of about 600 percent from the previous year. In the holiday period for 1999, it was listed by *Women's Wear Daily* as the most visited apparel site.

Our Businesses

Department Stores and Catalog is comprised of approximately 1,140 domestic and international JCPenney department stores, which are located in all 50 states, Puerto Rico, and Mexico. Virtually all store locations have catalog desks. JCPenney catalog, including e-commerce, is the nation's largest catalog merchant of general merchandise. In addition, the Company operates 35 Renner department stores in Brazil. Merchandise offerings for Department stores and catalog consist of family apparel, jewelry, shoes, accessories, and home furnishings.

Eckerd Drugstores is currently comprised of approximately 2,600 drugstores located in the Southeast, Sunbelt, and Northeast regions of the United States. Eckerd sells pharmaceuticals and related products, as well as general merchandise.

Direct Marketing Services is a direct marketing organization that markets life, health, accident, disability, and credit insurance, as well as membership services products. It markets to various credit card files by direct-response solicitation primarily in the United States, Canada, Australia, and the United Kingdom.



"My priority is to help build a company that focuses on the customer with wanted products of distinguishable quality and value; to present these offerings in a comfortable shopping environment, whether it's in a department store, drugstore, catalog, on the Internet, or through direct marketing. The result of these efforts should lead to increased stockholder value."

J. E. Oesterreicher,
Chairman of the Board and Chief Executive Officer

Our 37 years of experience in the catalog business, along with our extensive fulfillment infrastructure, give us an enormous competitive advantage in this arena. Our cross-channel synergies are invaluable assets, allowing JCPenney to lower costs as we leverage our common inventory and fulfillment capabilities, and give our customers greater choice and convenience. JCPenney can serve customer demand at every turn, whether it's in the store, in catalog, or online.

- Significant inventory process improvements at Eckerd. In 1999, we began implementation of a comprehensive supply-chain management system and took the first steps toward improving inventory control, margin reporting, and accounts payable processing. As we devote more resources to strengthen the Eckerd financial and merchandising systems, we expect the gains in accuracy and efficiency to give us better information for managing inventory and gross margin. We also see gross margin improvements coming from our efforts to improve front-end sales in 2000 and beyond.

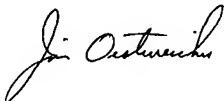
We also implemented a number of financial actions to create greater value.

- We completed the sale of our proprietary credit card receivables portfolio for approximately \$4 billion. This substantially reduced our debt to capital ratio from 62 percent in 1998 to approximately 54 percent in 1999. This will improve EVA and further strengthen our financial position.

In 2000, we will relaunch the card, introducing new marketing programs and enhanced benefits. We expect to capitalize on this stronger proprietary JCPenney card, especially its ability to stimulate sales, in all of our retailing formats.

- We announced plans for an initial public offering of 20 percent of a tracking stock for our Eckerd business some time in the second half of 2000, depending on performance and market conditions. This initiative has the potential of creating a sizeable increase in stockholder value. JCPenney today comprises complementary businesses with investment characteristics that appeal to two different types of investors. The drugstore tracking stock will keep our businesses together while giving investors an opportunity to invest in both a department store and drugstore security. After the offering is complete, we intend to use the IPO proceeds to buy back a substantial amount of JCPenney stock.

We are implementing substantial change at JCPenney — change that is different and more extensive than ever before in our history. We have a tremendous amount of work in front of us, and we know we have to move quickly.



J. E. Oesterreicher



In 1999, a task force was charged with formulating a plan and putting systems in place to centralize JCPenney's merchandising process. In January 2000, field and home office associates gathered to learn about their roles in implementing the changes.



Changes in our merchandising process will allow JCPenney store teams to renew their focus on improving customer service, merchandise presentation, and creating a convenient shopping experience.

"The world around us is changing faster than any time in history, and with these changes, our customers demand an ever-expanding array of products, services, and shopping experiences. We are diligently combining the power of our associates, stores, Internet, and catalog into a force that no competitor can match. It is a force our customers will reward. It is a force that is expected from the heritage of our brand, JCPenney."

Vanessa Castagna,
Chief Operating Officer for JCPenney Stores, Merchandising, and Catalog



Department Stores And Catalog

Our 1999 results proved to us that we must be more agile and focused. Sales for stores and catalog were \$19 billion, a 0.8 percent decline from the prior year — and an indication we did not keep pace with the changing needs of our customers.

Our mission for 2000 is to combine the power, resources, and the reach of JCPenney with the energy, agility, and spirit of a small company; to create a leaner organization clearly focused on the customer's needs with a fully integrated store, catalog, and Internet operation.

To manage this transformation of JCPenney into a powerful, competitive engine, we engaged some of the top performers in the retail industry, including:

- Vanessa Castagna, Chief Operating Officer for JCPenney Stores, Merchandising, and Catalog. Vanessa brings 27 years of retailing experience and was most recently a senior vice president and general merchandise manager at Wal-Mart stores division.

- Steve Farley, Chief Marketing Officer. Steve came to JCPenney with eight years' experience with Payless Shoes, two years with Pizza Hut, and ten years' ad agency experience.

- Paul Pappajohn, head of our e-commerce operations. Paul joined us after three years with Washington Post/Newsweek Interactive as vice president for development and e-commerce and previously spent three years at Disney Interactive.

Our next critical step was aligning management's efforts throughout the organization with the overall objectives of the Company. Our new compensation plan helps accomplish this. The result will be improved performance enterprisewide as associates redirect their individual store or departmental goals to focus on building the JCPenney brand.

Department Stores

NEW MERCHANDISING PROCESS

Over the course of 1999, we developed a plan to better serve our customers with current, fashion-right merchandise and unquestionable value. Beginning in 2000, merchandise action teams are accountable for product assortments from initial planning and development to sell-through. The financial planning, merchandise assortment, distribution, and replenishment functions are fully integrated through the new process.

Inventories will be flowed in weekly rather than quarterly, allowing us to keep ahead of changing fashion trends and react more quickly to capitalize on fast-selling items. We have also incorporated suppliers into the process, making them an integral part of managing replenishment.

For our stockholders, the resulting reduced levels of inventory will mean fewer markdowns and more profit for the bottom line. For our customers, the new process will mean timely delivery of current fashion trends and a shopping experience that exceeds their expectations, including improved customer service and merchandise presentation. The new process is expected to be fully implemented by the first quarter of 2001.

BUILDING ON A STRONG FOUNDATION

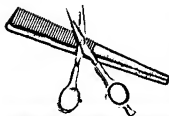
Another prime component of JCPenney's strategy is to powerfully leverage our strengths. We maintain the enviable position of having more retail space in major regional shopping centers than any other department store retailer in America, with about 1,140 department stores located in all 50 states. Several other key areas also leave us well-positioned for 2000.

Private brands. JCPenney's portfolio of powerful private brands includes The Original Arizona Jean Company®, St. John's Bay®, and the JCPenney Home Collection™. In keeping with our mission to improve corporate agility, this year we consolidated our 54 private-label brands to 34, with concentration on eight brands, and rolled out private-label in-store shops for four key brands across the chain. The resulting focus and flexibility helped increase sales for these brands by 5.6 percent in 1999.

Customer service. Convenience is a top priority for customers. Nowhere else can they enjoy our wide array of services, such as jewelry repair, styling salon, gift wrap, catalog pickup, optical, gift registry, and tailoring, as well as the convenience of shopping from our stores, catalog, and Internet site. We will continue to build on these services to address the needs of our customers' busy lifestyles.

International. Our international business continues to grow. We had notable success with our entry into Brazil, which began with acquiring 21 stores from Lojas Renner S.A. in January 1999. We opened 14 stores in 1999 and have another 14 stores planned in 2000. Renner has expanded into major markets, such as Rio de Janeiro, Brasília, and Belo Horizonte, and has increased its penetration in São Paulo. Renner is now recognized by the industry as a national department store.

In 2000, we also expect to open a JCPenney store in the World Trade Center in Mexico City, giving us three stores in Mexico. A grand opening in Puerto Rico increased our presence there to seven stores. Brazil and Mexico continue to afford our international business significant expansion opportunities.



Stepping up recruiting efforts for stylists enabled our JCPenney Salon business to post gains of nearly four percent and surpass the \$500 million mark.



Always on the lookout for hot trends, JCPenney capitalized on the Pokémon craze with a cross-divisional effort that moved five million units of apparel, toys, and trading cards.



More than 1.5 million Internet customers signed up to receive e-mail promotions from JCPenney.



"Our offering of store, catalog, and Internet shopping is the ultimate in customer convenience. We are the only retailer to offer this unique collection of options and variety of merchandise to our customer. She can come in, call in, or log on at JCPenney."

Randy Ronning, President of JCPenney Catalog and Logistics



For 37 years, JCPenney has built its catalog business on the highest levels of customer service and operational efficiencies. That fulfillment experience and 11 million square feet of warehouse space make us a formidable competitor in the Internet arena.



"Streamlining our inventory has opened up our sales floor. We have more room to spotlight key fashion statements. Customers don't have to dig. They can walk down an aisle and see the entire outfit they've been looking for, completely pulled together. It's like we've done the shopping for them."

Gary Shaffer, Store Manager

ACTIONS TO COME IN 2000 AND BEYOND

In 2000, we will continue to build a progressive organization focused on developing capabilities that increase our agility and deliver value for our customers and stockholders.

Speed merchandise delivery. Centralizing our merchandising process shaves weeks from our business cycle, enabling our stores, catalog, and our Internet site to receive merchandise faster. In August, we will roll out "floor ready" merchandise programs to reduce stockroom processing. Both efforts will expedite critical fashion offerings to our customers.

Reduce inventory. Faster, more frequent merchandise replenishment will reduce the need for large back-up inventories in our stockrooms. In 2000, we will also continue to reduce inventory on our sales floors and make key, market-right items the focus of our merchandise presentations to create a simpler, more pleasant shopping environment. This will also benefit JCPenney sales associates, who can spend less time preparing merchandise, and more time serving customers.

Simplify pricing. Our goal is to provide unquestionable day-in, day-out value to our customers, while maintaining fashion authority. To that end, we developed a cohesive plan for 2000 that tames the peaks and valleys of promotional pricing and, in fact, reduces promotional markdowns during key events. Price Image Drivers, high-demand national-brand items priced below suggested retail, will also enhance our value statement.

Focus marketing. A new integrated "Total Store" marketing strategy for the JCPenney brand will allow us to apply greater resources to things that matter most — and shed costs on things that matter least. This strategy encompasses the total customer experience, including the personality of the store, with a clear understanding of the role each merchandise category plays in growing our target-customer base. Additionally, a new agency has been hired to help communicate our "Total Store" plan at all points of contact with the consumer.

Catalog / Internet

In 1999, in only its second year of operation, jcpenny.com sales jumped from \$15 million to \$102 million. Our success is in no small measure due to the 37 years of experience we have gained from our \$4 billion catalog business.

The infrastructure behind this business — from fulfillment and distribution centers to our telemarketing network, combined with catalog desks in stores and drugstores across the country — gives us an enormous competitive advantage that other retailers are still scrambling to build.

Holiday success. Our vast fulfillment infrastructure let us put our entire 1999 Fall/Winter Catalog of more than 200,000 items online in time for the holidays. While many e-tailers struggled to smoothly and quickly fill customer orders, most JCPenney customers received packages in two to three working days. Plus, our Internet customers could walk into any of our more than 2,000 catalog locations, including JCPenney stores and selected Eckerd drugstores, to handle customer service issues, such as exchanges or returns, on items purchased from jcpenny.com.

New features. This year we added new features to the jcpenny.com experience. We launched a service for full-figured women with our Just4MePlus site. There a customer can create a three-dimensional model that mirrors her own measurements, then try on clothes online. This year we'll be adding a "will-call" privilege — online shoppers can pick up their orders in a JCPenney store or at the catalog desk of select Eckerd stores, creating additional store traffic.

Cross promotions. The synergy of our stores, catalog, and Internet site is an advantage prominently displayed in our promotional advertising and wherever our customers shop JCPenney. With our database of 50 million customers, we can uniquely capitalize on significant cross-channel marketing opportunities, reducing expenses as we leverage our common inventories and cost-efficient fulfillment.

Future. E-commerce gives JCPenney a tremendous opportunity to provide the customer with multichannel convenience. No matter where customers choose to shop, we plan to be there for them — whether they come into our stores, call our catalog, or log on to our Internet site. We continue to see the Internet as a terrific growth opportunity, and we are aggressively pursuing future growth with an expected increase in sales to more than \$1 billion over the next three years.



Item-specific
TV commercials gave
our diamond business
a 34 percent sales
gain in December.



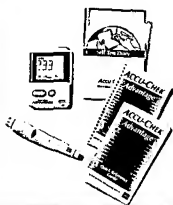
We dialed up our
contemporary menswear
with the launch of our
own J. Ferrar label,
followed by Crazy Horse
for Men in February 2000.



Our women's
line of St. John's Bay
casual apparel
experienced double-
digit sales gains
for the year.



With growth averaging 108 percent monthly, online orders represented nearly seven percent of prescription refills at Eckerd Health Services mail pharmacy and express pharmacy services.



Eckerd.com added a link so diabetics can order medical supplies to treat their condition, as well as diabetic-friendly products for personal hygiene and daily nutrition.



In December, eckerd.com launched a personalized vitamin option. Customers key in their health information and are mailed a complete vitamin regimen tailored to their lifestyles.

Eckerd Drugstores

ECKERD TODAY

As one of the largest drugstore chains in the United States, Eckerd is a strategic part of JCPenney's business plan. At year end, Eckerd operated nearly 2,900 stores in 20 states. Eckerd ranks number one or number two in 34 major markets. Our stores are positioned in the southeastern and southwestern Sunbelt states, which include the growing retirement destinations of Florida, Texas, and the Carolinas, as well as in the heavily populated northeastern corridor of the country.

In March 1999, we acquired Genovese Drugstores, adding 141 prime locations mainly in the New York metro area, a market known for the cost and scarcity of good locations. With virtually no store overlap, this acquisition catapulted us to first in sales in New York state and added more than \$900 million in annualized sales.

Eckerd continues to be a strong competitor in an industry with enormous growth potential. In 1999, Eckerd had revenues of over \$12 billion and increased comparable store sales by more than ten percent and comparable store pharmacy sales by 15 percent.

GENERATING HIGHER RETURNS

While we were pleased with these top-line increases, our margins for the year were not as strong as we would have liked. As a result, we took a number of steps in 1999 to address key issues affecting the Company's earnings to position Eckerd for substantial profit growth.

Eckerd store base review. Underperforming older stores and start-up costs for newer stores had adverse impacts on the Company's profit margins. To address this, management conducted a complete review of Eckerd's store base. Consequently, we identified a number of underperforming stores and in the first quarter announced plans to close 289 drugstores. We expect to open approximately 200 new stores in 2000, of which about 150 will be relocations.

Inventory management processes. Actions were taken in 1999 to address higher-than-anticipated inventory shrinkage associated with the integration of various acquired retail drugstore formats. These included integration of the accounts payable system into the automated JCPenney system and strengthening of inventory management processes and systems. Significant investments were and will continue to be made in technology that allows us to lower costs and tighten controls.

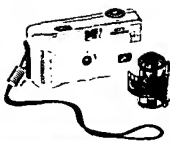
Pharmacy gross margins. The growing number of prescriptions filled through managed care plans in 1999, coupled with a higher percentage of new, low-margin branded drug introductions, translated into greater margin pressure on pharmacy sales. Management has worked to adjust contract requirements with managed care providers to improve reimbursement policies. Generic prescriptions, which bring lower costs to consumers and higher margins, are also being actively promoted as alternative drug choices, where appropriate.

With the integration of multiple drugstore formats behind us, our strong position and solid sales momentum leave us well-positioned to capitalize on favorable demographic trends within the drugstore industry. Our focus is now centered on improving the profitability of our operation.

J. E. Oesterreicher



Relocating older strip-center stores to freestanding locations with drive-through pharmacies is a core business strategy and typically results in 30 percent sales gains during the first full year.



The Express Shot camera generated significant photo processing increases. Return it to Eckerd for photo developing, and it's reloaded with film at no charge for the life of the camera.



A new store presentation of Eckerd's vitamin and mineral assortment, complete with educational graphics, led to double-digit margin improvement.



Eckerd was first to market with the launch of Neutrogena and Oil of Olay cosmetics. This early introduction resulted in market share levels twice the share of overall cosmetics sales.

FUTURE GROWTH

We continue to be very pleased with the performance of Eckerd's new and relocated stores, which remain a key growth opportunity for the Company. With the steps that have been taken in the last year to identify and eliminate underperforming stores, improve systems and processes, and move our focus from integration to business development, Eckerd is poised to take advantage of numerous opportunities for growth in 2000.

Growing customer base. Current demographic studies suggest that the United States is heading for a major population shift in which more Americans will begin enjoying their golden years. For most of the country, the above-65 age group is projected to grow at about five percent per year. In some markets, such as Florida, Texas, Virginia, and the Carolinas, this rate is expected to more than double. Eckerd, which is strongly represented in these key markets, is uniquely situated to serve this fast-growing segment of the population.

Convenient locations. Today's consumers, who are driven more and more by convenience, are increasingly drawn to freestanding, neighborhood stores. The relocation of older strip-center Eckerd stores into new freestanding locations with drive-through pharmacies should continue to generate strong sales gains.

New features and product introductions. Eckerd's strong relationships with suppliers of key national brands often allow us to offer new products unavailable elsewhere. For example, we were the first retailer to stock and market Gillette's highly publicized Mach 3 Razor, the Revitalique and Feria hair color lines, the popular fat-free Pringles, and the new Oil of Olay cosmetics line. In each case, being first to market resulted not only in strong market share for these new items during their introduction, but also sustained share levels greater than that for the category as a whole. We will continue to exploit the growth opportunity behind this strategy in the coming fiscal year.

Eckerd Health Services. Our Eckerd Health Services Pharmacy Benefits Management (PBM) system has the capability to design, sell, and administer prescription benefit plans for employers and HMOs. Our PBM network includes more than 50,000 participating pharmacies and one of the nation's largest retail mail-service pharmacies. Our PBM system will continue to contribute important growth as our number of covered lives is expected to increase by more than 20 percent in 2000 from its base of three million.

Eckerd.com. Building on 100 years of pharmacy trust and service, Eckerd's e-commerce site was expanded during the year to include valuable advice on a wide range of health topics, an extensive assortment of health and beauty aids and other products, as well as all pharmacy prescription services. Future enhancements will include expanded advice on health and wellness and a unique personalized vitamin service.

Synergy with JCPenney. The relationship between Eckerd and JCPenney provides strong and strategic competitive advantages. In addition to increased buying power, Eckerd and JCPenney stores benefit from potential cross-promotional, cobranding initiatives and other synergies.

In 1999, nearly 300 JCPenney catalog centers opened in Eckerd drugstores. At these locations, consumers have the opportunity to order merchandise from any JCPenney catalog, as well as from jcpenny.com, and have it delivered for pickup. Additional locations and markets will be evaluated.

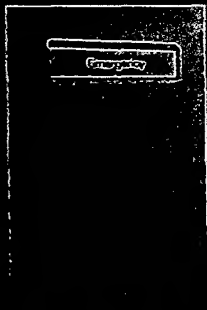
Other synergies between Eckerd and JCPenney include the opportunity to use the JCPenney credit card at all Company retail locations. In addition, we are testing private-brand JCPenney hosiery and other products in Eckerd drugstores.



The projected annual growth rate of America's senior citizen population is five percent. In Eckerd's larger markets of Florida, Texas, Virginia, and the Carolinas—popular retirement areas—the rate is double that, leaving Eckerd well-positioned in the pharmacy industry.



Eckerd's expanded assortment of convenience products complements our pharmacy offerings.



During their time of need, more than 350,000 families have relied on insurance products from Direct Marketing Services for \$1.4 billion in benefits.



Direct Marketing Services has used traditional telemarketing and direct mail to achieve its 12th consecutive year of profitable growth and plans to expand its marketing vehicles to include direct-response television and Internet solicitation.

"We are extremely rich in customer information and direct marketing skills, allowing us to develop customers for the entire JCPenney enterprise and our business partners. What we're talking about is a first-class direct marketing company that is becoming a customer development company."

Bob Romasco, President of Direct Marketing Services



Direct Marketing Services

Direct Marketing Services uses telemarketing and direct mail to market a number of insurance products including life, health, accident, supplemental hospital, and credit insurance, as well as membership services. Over the past five years, Direct Marketing Services has shown a compound annual growth rate of 15 percent in revenue and 14 percent in earnings, and in 1999 completed its 12th consecutive year of revenue and earnings growth.

Our vision is for Direct Marketing Services to be a world-class direct-marketing company and second to none in customer understanding, responsiveness, and anticipation. To achieve this vision and continue its strong historical growth, Direct Marketing Services began a transformation to a new business model in 1999. The change was from a single channel, modest product set to a needs-driven, multiple-channel, multiple-product customer development company.

Strategic direction. Early in the year, Direct Marketing Services management conducted a comprehensive strategic review, including extensive customer and competitive research, to identify additional growth opportunities. The resulting strategy centered on expansion of our direct-marketing capabilities, leveraging our considerable information assets and targeting skills, and providing superior customer development capabilities to JCPenney and our 45 business partners. The plan included product development priorities geared to specific customer segments, development of additional direct-marketing channels, such as direct-response television, inbound telephone, and enhanced direct mail, as well as extensive use of the Internet for both sales and service activity.

1999's strong growth came from insurance and the continued expansion of membership-services products, especially PlanPlus, a discount health product plan that delivers strong value. Direct Marketing Services also continued its planned international expansion. Programs were successfully launched in Australia and are now under way with two of the United Kingdom's most prestigious banks.

Direct Marketing Services also test marketed several new products in 1999, including disability insurance (in partnership with Unum, the nation's leading provider in this category), Pet Club, and the Eckerd HealthCare Discount Plan. Customer loyalty helped the Eckerd program, in a limited test in Florida, produce positive results and additional sales for both Eckerd and Direct Marketing Services. In each case, our plan is to use new integrated marketing channels in addition to traditional telemarketing.

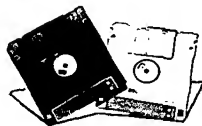
Growth potential. In 2000, Direct Marketing Services will continue to develop new products in both insurance and membership services. Increased focus on customer retention and product cross-selling will combine with new-customer acquisition efforts to produce continued profitable growth. With nearly 50 million unique customers across the JCPenney family of companies and an additional 50 million among our valued business partners, this dual focus affords significant growth opportunity. Our goal is to develop these capabilities over the next 36 months as we continue to expand our business.



Research identified our target customers as a prime market for a pet wellness product and led to the successful launch of Pet Club in 1999.



Customer loyalty was key in the successful test marketing of our PlanPlus product under the name Eckerd HealthCare Discount Plan.



We completed a segmentation initiative on customers in our database to better understand their interests and refine our targeting strategy.

Financial Review

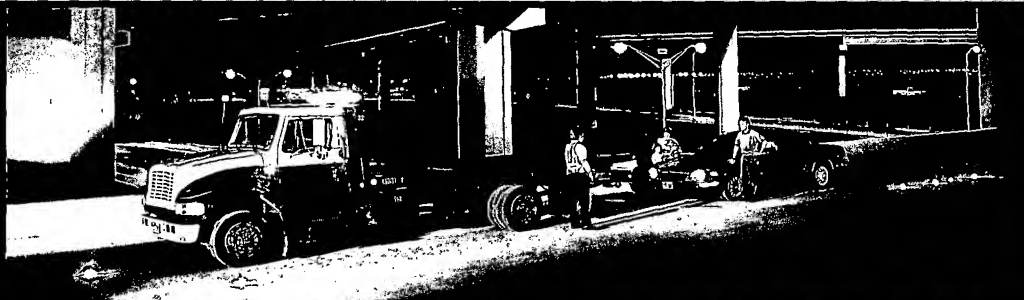
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defenney's ranking as the highest-volume department store retailer of women's shoes begins with sourcing.



photopac services are provided to its members.



Direct Marketing Services offers an array of membership services, such as roadside assistance.

*Management's Discussion and Analysis
of Financial Condition and Results of Operations*

Results of Operations

J. C. PENNEY COMPANY, INC.

<i>(\$ in millions except EPS)</i>	52 Weeks 1999	52 Weeks 1998	53 Weeks 1997
Segment profit			
Department stores and catalog ⁽¹⁾	\$ 670	\$ 920	\$ 1,275
Eckerd drugstores	183	254	347
Direct Marketing ⁽²⁾	247	237	217
Total segments	1,100	1,411	1,839
Real estate and other	28	26	39
Net interest expense and credit operations ^(1,2)	(299)	(391)	(457)
Acquisition amortization	(129)	(113)	(117)
Other charges and credits, net	(169)	22	(379)
Income before income taxes	531	955	925
Income taxes	(195)	(361)	(359)
Net income	\$ 336	\$ 594	\$ 566
Earnings per share (EPS)	\$ 1.16	\$ 2.19	\$ 2.10

(1) Reflects the reclassification of certain credit costs, primarily third-party credit fees of \$91 million in 1998 and \$93 million in both 1998 and 1997 from Net interest expense and credit operations to Department stores and catalog SG&A expenses.

(2) Reflects the reclassification of interest charges of \$5 million, \$4 million and \$3 million for 1999, 1998 and 1997, respectively, from Direct Marketing operating expenses to Net interest expense and credit operations.

Net income in 1999 totaled \$336 million, or \$1.16 per share, compared with \$594 million, or \$2.19 per share, in 1998, and \$566 million, or \$2.10 per share, in 1997. Consolidated results reflect non-comparable items as shown below. Excluding non-comparable items, earnings per share totaled \$1.69 in 1999 compared with \$2.14 in 1998 and \$2.96 in 1997. All references to earnings per share are on a diluted basis.

<i>(\$, net of tax, in millions except EPS)</i>	1999		1998		1997	
	\$	EPS	\$	EPS	\$	EPS
Earnings before non-comparable items	\$ 474	\$ 1.69	\$ 581	\$ 2.14	\$ 797	\$ 2.96
Non-comparable items						
Asset impairment charges	(169)	(0.65)	—	—	(44)	(0.16)
Gain on the sale of assets	33	0.13	—	—	38	0.14
Workforce reduction programs	—	—	—	—	(126)	(0.47)
Store closing costs	—	—	—	—	(37)	(0.14)
Drugstore integration costs	—	—	—	—	(62)	(0.23)
Other	(2) ⁽¹⁾	(0.01)	13	0.05	—	—
Total non-comparable items	(138)	(0.53)	13	0.05	(231)	(0.86)
Net income	\$ 336	\$ 1.16	\$ 594	\$ 2.19	\$ 566	\$ 2.10

(1) Includes a \$12 million after-tax charge, or five cents per share, for the impact of changes in certain revenue recognition policies to comply with SAB No. 101 that is included as a component of Department stores and catalog segment profit. All other items are reported as Other charges and credits, net.

These non-comparable items are discussed in more detail within management's discussion of Department stores and catalog results and Other charges and credits, net, as well as in Note 14 to the consolidated financial statements.

Total segment profit was \$1,100 million in 1999 compared to \$1,411 million in 1998 and \$1,839 million in 1997. Segment profit has declined principally as a result of lower sales volumes in department stores coupled with declining Department stores and catalog gross profit margins and lower pharmacy gross profit margins coupled with higher shrinkage rates within the drugstore segment. Consolidated results reflect continued improvement in proprietary credit operating costs for both 1999 and 1998 primarily as a result of declining bad debt expense throughout the three-year period.

The following discussion addresses results of operations on a segment basis.

DEPARTMENT STORES AND CATALOG

(\$ in millions)	52 Weeks 1999	52 Weeks 1998	53 Weeks 1997
Retail sales, net	\$ 18,964	\$ 19,114	\$ 19,819
FIFO gross margin	5,607	5,697	6,152
LIFO credit	9	35	20
Total gross margin	5,616	5,732	6,172
SG&A expenses	(4,946)	(4,812)	(4,897)
Segment profit	\$ 670	\$ 920	\$ 1,275
Sales percent inc/(dec)			
Department stores ⁽¹⁾	(1.4)%	(3.1)%	0.9%
Comparable stores	(1.1)%	(1.9)%	(0.3)%
Catalog ⁽¹⁾	1.5%	0.3%	3.2%
Ratios as a percent of sales			
FIFO gross margin	29.6%	29.8%	31.0%
LIFO gross margin	29.6%	30.0%	31.1%
SG&A expenses	26.1%	25.2%	24.7%
LIFO segment profit	3.5%	4.8%	6.4%
LIFO EBITDA ⁽²⁾	7.2%	8.0%	8.9%

(1) Sales comparisons are shown on a 52-week basis for all periods presented. Including 1997's 53rd week, department store sales declined by 4.3 percent in 1998 and increased 2.2 percent in 1997, while catalog sales decreased by 0.6 percent in 1998 and increased by 4.2 percent in 1997.

(2) Earnings before interest, income taxes, depreciation and amortization. EBITDA includes finance revenue net of credit operating costs and bad debt. EBITDA is provided as an alternative assessment of operating performance and is not intended to be a substitute for GAAP measurements. Calculations may vary for other companies.

Department stores and catalog operating results have been restated for all years presented to reflect the following:

a) In 1999, after giving consideration to guidance provided by SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, the Company changed certain revenue recognition policies, primarily those affecting the reporting of sales for licensed departments and catalog orders shipped to various Company facilities for customer pickup. These changes reduced sales by \$152 million, \$217 million and \$136 million in 1999, 1998 and 1997, respectively, and resulted in a \$67 million reduction of reinvested earnings, net of tax, as of January 28, 1995. The impact on earnings and cash flows for the intervening periods presented in this report is not material. Accordingly, the cumulative effects of the changes have been reflected as a \$20 million pre-tax charge to cost of goods sold in the statement of income for fiscal 1999, the period in which the change was made.

b) Third-party credit fees of \$91 million in 1999 and \$93 million in both 1998 and 1997 have been reclassified from Net interest expense and credit operations to Department stores and catalog SG&A expenses to reflect these costs as operating expenses.

1999 compared with 1998. Segment profit for Department stores and catalog totaled \$670 million in 1999 compared with \$920 million in 1998. The decline for the year was attributable primarily to lower sales volumes in department stores. Total department store sales of \$15.0 billion declined 1.4 percent for the year while sales in comparable department stores (those open at least one year) declined by 1.1 percent. Sales were strongest in women's casual sportswear, which benefited from the introduction of additional supplier exclusive product offerings, primarily Crazy Horse by Liz Claiborne, and window coverings. Sales were especially soft in athletic apparel and adult athletic shoes. Sales were led by private brand merchandise; Arizona Jean, the JCPenney Home Collection, and Delicates™ all produced double-digit sales gains. In general, sales of national brand merchandise were below expectations. Total department store sales were weak across all regions of the country. Sales in the Company's international stores totaled \$432 million in 1999, an increase of \$169 million compared with the prior year. The increase is predominantly the result of the acquisition of a majority interest in Lojas Renner S.A. (Renner), a Brazilian department store chain, in January 1999. Sales were also impacted by the exit of the Chilean market in 1999's third quarter. Catalog sales were

approximately \$3.9 billion in both 1999 and 1998. For the year, specialty media, which includes targeted merchandise offerings like special sizes, enjoyed a double-digit sales increase. Big book sales were basically flat in 1999 versus 1998. Catalog sales were strongest in merchandise for the home, and were weakest in apparel. Internet sales, which are reported as a component of catalog sales, increased from \$15 million in 1998 to \$102 million in 1999.

Gross margin as a percent of sales declined by 40 basis points compared with 1998 levels, with 20 basis points attributable to a smaller LIFO credit this year. The margin decline was due primarily to higher levels of promotional and clearance markdowns in the fourth quarter which were partially offset by the shift in sales to higher margin private brands. Gross margin included LIFO credits of \$9 million in 1999 and \$35 million in 1998. The LIFO credits for both years resulted from a combination of flat to declining retail prices as measured by the Company's internally developed inflation index, and improved markup. SG&A expenses increased by 90 basis points as a percent of sales versus last year. The increase was principally a function of lower sales volumes coupled with additional investments in Internet infrastructure and higher selling salaries in department stores.

1998 compared with 1997. Segment profit totaled \$920 million in 1998 compared with \$1,275 million in 1997. The decline for the year was primarily attributable to lower sales coupled with a lower gross margin ratio. Sales in comparable department stores declined by 1.9 percent in 1998. Department store sales were strongest in women's apparel, while athletic apparel and footwear were particularly hard hit by softening sales throughout 1998. Catalog sales increased by 0.3 percent on a 52-week basis.

Gross margin as a percent of sales for Department stores and catalog declined by 110 basis points compared with 1997, principally as a result of promotional programs during the fourth quarter. As the fourth quarter progressed, the Company increased promotions to stimulate sales. While this generated unit sales and helped to reduce seasonal inventory levels, it had a negative impact on the gross margin ratio. Markup improved in 1998 as the Company continued to drive down its merchandise sourcing costs and improved efficiencies with its supplier base. The improvement in markup partially offset the effects of the higher markdowns. Gross margin included LIFO credits of \$35 million in 1998 and \$20 million in 1997. SG&A expenses, while controlled, were not leveraged as a percent of sales due to sales declines. In 1998 the Company realized

savings of approximately \$95 million related to the early retirement and workforce reduction programs as well as other cost-saving initiatives. These savings were reinvested in programs designed to enhance customer service in the stores and into advertising and promotional programs.

ECKERD DRUGSTORES

	52 Weeks 1999	52 Weeks 1998	53 Weeks 1997
(\$ in millions)			
Retail sales, net	\$ 12,427	\$ 10,325	\$ 9,663
FIFO gross margin	2,453	2,110	2,048
LIFO charge	(52)	(45)	(32)
Total gross margin	2,401	2,065	2,016
SG&A expenses	(2,218)	(1,811)	(1,669)
Segment profit	\$ 183	\$ 254	\$ 347
Sales percent increase			
Total sales ⁽¹⁾	20.4%	8.9%	11.2% ⁽²⁾
Comparable stores	10.7%	9.2%	7.4%
Ratios as a percent of sales			
FIFO gross margin	19.7%	20.4%	21.2%
LIFO gross margin	19.3%	20.0%	20.9%
SG&A expenses	17.8%	17.5%	17.3%
LIFO segment profit	1.5%	2.5%	3.6%
LIFO EBITDA ⁽³⁾	3.0%	3.8%	4.7%

(1) Sales comparisons are shown on a 52-week basis for all periods presented. Including 1997's 53rd week, drugstore sales increased by 6.9 percent and 13.3 percent for 1998 and 1997, respectively.

(2) 1997 sales increase is calculated based upon 1996 pro forma sales, assuming Eckerd was acquired at the beginning of 1996.

(3) Earnings before interest, income taxes, depreciation, and amortization. EBITDA is provided as an alternative assessment of operating performance and is not intended to be a substitute for GAAP measurements. Calculations may vary for other companies.

1999 compared with 1998. Segment profit for the drugstore segment totaled \$183 million in 1999 compared with \$254 million in 1998. The decline in operating profit was attributable to both lower gross margins and higher SG&A expense. Sales growth was strong the entire year. Total sales for 1999 increased by 20.4 percent over the prior year and include approximately \$830 million in sales attributable to the Genovese drugstores acquired in March 1999. Comparable store sales were strong, increasing 10.7 percent (including the pro forma results of the Genovese drugstores) compared to a 9.2 percent increase in the prior year. Comparable store sales growth was led by a 15.6 percent increase in pharmacy sales, which accounted for 62 percent of total drugstore sales. Pharmacy sales were particularly strong in the managed care

segment, which accounted for 87 percent of total pharmacy sales. Comparable non-pharmacy merchandise sales increased 3.0 percent for the year and were strongest in one-hour photo processing and over-the-counter drugs. 1999 sales also benefited from the relocation of 208 stores to more convenient freestanding locations. Relocated stores typically generate sales increases of approximately 30 percent in their first full year of operation.

Gross margin as a percent of sales declined by 70 basis points. The decline was principally related to (i) a higher proportion of lower gross margin managed care and mail-order pharmacy sales, (ii) a higher percentage of new, lower-margin drug introductions and (iii) higher shrinkage. Gross margin included LIFO charges of \$52 million in 1999 and \$45 million in 1998.

SG&A expenses as a percent of sales in 1999 increased by 30 basis points over the prior year. Current year expenses include \$45 million of charges recorded in the second quarter related to systems upgrades and increases in certain balance sheet reserves. SG&A expenses in 1999 also reflect integration costs for the Genovese acquisition as well as costs associated with opening more new and relocated stores in 1999 than in the prior year.

1998 compared with 1997. Segment profit totaled \$254 million in 1998 compared with \$347 million for the prior year. Total sales increased 8.9 percent over 1997 levels on a 52-week basis and increased 9.2 percent for comparable stores. Sales growth was fueled by a 15.0 percent gain in comparable pharmacy sales which accounted for approximately 60 percent of total drugstore sales. Managed care sales grew at a particularly strong pace, increasing to 85 percent of pharmacy sales from 80 percent in the prior year. Non-pharmacy merchandise sales increased 1.5 percent for the year and strengthened as the year progressed. Sales also benefited from the relocation of 175 stores to more convenient, freestanding locations during the year.

Gross margin as a percent of sales declined by 90 basis points in 1998. Both 1998 and 1997 included charges related to the liquidation of nonconforming merchandise resulting from the conversion of the former Thrift, Fays, Kerr and certain acquired Rite Aid and Revco drugstores into the Eckerd name and format. These charges totaled \$98 million in 1998 and \$45 million in 1997. Excluding these charges, gross margin declined by 40 basis points in 1998. Gross margin declines were principally attributable to a higher

percentage of pharmacy sales, especially managed care sales, which carry lower margins. Gross margin for non-pharmacy merchandise improved for the year. Gross margin included a LIFO charge of \$45 million in 1998 compared with a \$32 million charge in 1997.

SG&A expenses as a percent of sales increased by 20 basis points in 1998 and were negatively impacted by additional staffing costs in connection with the integration of the various drugstore formats during the first half of the year.

DIRECT MARKETING

(\$ in millions)	1999	1998	1997
Revenue			
Insurance premiums, net	\$ 937	\$ 872	\$ 800
Membership fees	93	65	50
Investment income	89	85	78
Total revenue	1,119	1,022	928
Claims and benefits	(372)	(340)	(332)
Deferred acquisition costs	(227)	(195)	(170)
Other operating expenses ⁽¹⁾	(273)	(250)	(209)
Segment profit	\$ 247	\$ 237	\$ 217
Revenue percent increase	9.5%	10.1%	13.4%
Segment profit increase	4.2%	9.2%	14.8%
Segment profit as a percent of revenue	22.1%	23.2%	23.4%

(1) Reflects the reclassification of interest charges of \$5 million, \$4 million and \$3 million for 1999, 1998 and 1997, respectively, from operating expenses to Net interest expense and credit operations.

Results for J. C. Penney Direct Marketing Services, Inc. (Direct Marketing) for 1999 reflect the 12th consecutive year of both revenue and profit improvement. Segment profit for Direct Marketing was \$247 million in 1999 compared with \$237 million in 1998 and \$217 million in 1997. Total revenue exceeded \$1.1 billion in 1999, increasing from \$1.0 billion in 1998 and \$0.9 billion in 1997. Health insurance premiums account for the majority of the revenue increases in both 1999 and 1998, and represent in excess of 70 percent of total insurance premiums and 60 percent of total revenue. Revenue growth for the three-year period is primarily attributable to successfully maintaining and enhancing marketing relationships with businesses, principally banks, oil companies and retailers, for the sale of insurance products throughout the United States and Canada.

1999 marked the first year that more than 50 percent of total revenue was generated through non-JCPenney business relationships. Direct Marketing continued its international expansion in 1999 with active programs with two United Kingdom banks, programs launched in Australia and activity initiated in South Korea.

Membership services contributed eight percent of total revenues in 1999 and continued to be a growing component of the segment, increasing 43 percent and 30 percent in 1999 and 1998, respectively. Memberships include dental, pharmacy, vision and hearing benefits, as well as auto and travel services.

NET INTEREST EXPENSE AND CREDIT OPERATIONS

<i>(\$ in millions)</i>	1999	1998	1997
Finance charge revenue, net of operating expenses	\$ (313)	\$ (224)	\$ (127)
Interest expense, net	612	615	584
Net interest expense and credit operations	\$ 299	\$ 391	\$ 457

Net interest expense and credit operations totaled \$299 million in 1999 compared with \$391 million in 1998 and \$457 million in 1997. 1999 includes the Company's proprietary credit card operation through December 6, 1999, when the operation was sold to General Electric Capital Corporation (GE Capital). 1998 and 1997 include the proprietary credit card operation for the full year. As noted previously, third-party credit costs of \$91 million in 1999 and \$93 million in both 1998 and 1997 have been reclassified to Department stores and catalog SG&A expense.

Declines in Net interest expense and credit operations in both 1999 and 1998 are related to improvements in credit operating performance, principally bad debt expense, throughout both years. The improvement was the result of favorable credit, industry trends as well as the Company's efforts to tighten credit underwriting standards to improve portfolio performance and reduce risk. These factors resulted in a steady decline in delinquency rates throughout 1999 and 1998. Interest expense declined slightly in 1999 compared with 1998 levels. Interest expense increased by approximately \$30 million in 1998 as a result of higher borrowing levels.

OTHER CHARGES AND CREDITS, NET

In the fourth quarter of 1999, the Company recorded net pre-tax charges of \$169 million comprised of three components. In December, the Company completed the sale of its proprietary credit card receivables to GE Capital. The total value of the transaction was \$4.0 billion, including debt that was assumed by GE Capital related to previous receivable securitization transactions. The Company recognized a pre-tax gain of \$55 million on the transaction, net of an allowance for final settlement. The Company also recorded pre-tax asset impairment charges of \$240 million related to underperforming store locations in both its department stores (\$130 million) and drugstores (\$110 million) in accordance with Statement of Financial Accounting Standards (FAS) No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*. The impairment charges represent the excess of the carrying values of the assets, including intangible assets, over estimated fair values. The department store charge relates to ten stores, with the majority attributable to seven stores in the Washington, D.C. market that were acquired in 1995. The Washington, D.C. stores have performed substantially below levels anticipated at the time of the acquisition, and the impairment charge generally represents goodwill associated with the acquisition. Drugstore impairment charges represent the write-off of fixed assets, including intangibles, associated with 289 stores located throughout Eckerd's operating area, with concentrations in Pennsylvania, Virginia, New Jersey and New York. The impaired stores generally represent smaller, low-volume stores that were former independent units and chains acquired over the last several years that do not meet Eckerd's performance standards and cannot be relocated. In addition, the Company recorded a pre-tax credit of \$16 million related to restructuring charges recorded in 1996 and 1997.

Other credits in 1998 also related to the reversal of store closing reserves established in 1997. In 1997, the Company recorded pre-tax charges of \$379 million related to early retirement and workforce reduction programs, the closing of underperforming department stores and drugstore integration charges.

INCOME TAXES

The effective income tax rate before considering the impact of Other charges and credits, net decreased to 34.3 percent in 1999 compared with 37.8 percent in 1998 and 38.8 percent in 1997. Declines over the three-year period are related primarily to the effects of tax planning strategies that have significantly reduced state and local effective income tax rates.

Financial Condition

Cash flow from operating activities was \$1,258 million in 1999 compared with \$1,058 million in 1998 and \$1,218 million in 1997. Efforts to reduce inventory levels and declines in capital expenditures had a positive impact on cash flow for the year. While net income has declined in recent years, cash flow has remained strong as a result of the impact of declines in customer accounts receivable and the increases in non-cash charges, primarily related to drugstore acquisitions store closings and asset impairments. 1999 cash flow from operations was sufficient to fund the Company's operating needs — working capital, capital expenditures and dividends. Management expects cash flow to cover the Company's operating needs for the foreseeable future. Although its credit ratings have declined over the past two years, the Company's liquidity position improved with the sale of its proprietary credit card receivables. Additionally, the Company continues to have access to the commercial paper market along with maintaining \$3.0 billion in committed bank credit facilities.

Merchandise inventory. Total LIFO inventory was \$5,947 million in 1999 compared with \$6,060 million in 1998 and \$6,191 million in 1997. FIFO merchandise inventory for Department stores and catalog was \$3,806 million at the end of 1999, a decrease of 7.4 percent on an overall basis and approximately eight percent for comparable stores. The decline was primarily the result of the Company's efforts to improve the merchandise procurement process and increase inventory turnover, coupled with aggressive clearance activities at the end of the year. Eckerd FIFO merchandise inventory was \$2,411 million at the end of 1999, an increase of 10.8 percent compared with the prior year. The increase was principally related to the acquisition of Genovese and growth in sales volumes.

Properties. Property, plant and equipment, net of accumulated depreciation, totaled \$5,312 million at January 29, 2000, compared with \$5,458 million and \$5,329 million at the ends of fiscal 1998 and 1997, respectively.

At the end of 1999, the Company operated 1,143 JCPenney department stores (including two stores in Mexico and six in Puerto Rico), 35 Renner department stores in Brazil and 2,898 Eckerd drugstores, which altogether represented in excess of 145 million gross square feet of retail space. JCPenney department store counts have declined recently principally as a result of the closing of underperforming stores. Eckerd store counts reflect the addition of 141 Genovese drugstores in March of 1999; the closing of underperforming and overlapping stores during the conversion of former drugstore formats to Eckerd; and the addition of 266 new and relocated stores in 1999 and nearly 700 over the past three years.

Capital expenditures

(\$ in millions)	1999	1998	1997
Department stores and catalog	\$ 318	\$ 420	\$ 443
Eckerd drugstores	283	256	341
Other corporate	5	20	26
Total	\$ 606	\$ 696	\$ 810

1999 capital spending levels for property, plant and equipment declined for Department stores and catalog. In 1999, the Company spent approximately \$108 million on existing department store locations compared with \$150 million in 1998 and \$200 million in 1997. It is expected that capital spending for Department stores and catalog will approximate \$500 million in 2000, with approximately \$120 million dedicated to the improvement of general store appearance. Capital spending for Eckerd drugstores increased in 1999, principally in the area of technology to strengthen its financial and operating systems. It is expected that spending within Eckerd drugstores will be in the \$300 million range, with substantial investments continuing to be made in systems and technology enhancements. While attention is focused on systems and technology, Eckerd's new and relocated store program will be reduced to approximately 200 stores, including about 150 relocations, for 2000 from the previous plan of about 300 stores. Total capital spending for 2000 is currently projected at approximately \$850 million.

Acquisitions. The Company has completed several acquisitions in recent years as noted below. In all cases, the purchase price was allocated to assets acquired and liabilities assumed based on estimated fair values. The excess of the purchase price over the fair value of assets acquired, including intangible assets, and liabilities assumed is accounted for as goodwill and is generally amortized over 40 years. All acquisitions have been accounted for under the purchase method. Accordingly, their results of operations are included in the Company's statements of income as of the date of the acquisition.

On March 1, 1999, the Company completed the acquisition of Genovese Drug Stores, Inc. (Genovese), a 141-drugstore chain with locations in New York, New Jersey and Connecticut. The acquisition was accomplished through the exchange of approximately 9.6 million shares of JCPenney common stock for the outstanding shares of Genovese, and the conversion of outstanding Genovese stock options into

approximately 550 thousand common stock options of the Company. The total value of the transaction, including the assumption of \$60 million of debt, was \$414 million, of which \$263 million represented goodwill.

The Company completed the acquisition of a majority interest in Lojas Renner S.A. (Renner), a 21-store Brazilian department store chain, in January 1999. The total purchase price was \$139 million, of which \$67 million represented goodwill.

During fiscal 1998, Direct Marketing formed Quest Membership Services, Inc. and acquired Insurance Consultants, Inc., strengthening its access to other business relationships. The total purchase price was approximately \$72 million, of which \$53 million represented goodwill.

Intangible assets. At the end of 1999, Goodwill and other intangible assets, net, totaled \$3,056 million compared with \$2,941 million in 1998 and \$2,940 million in 1997. Intangible assets consist principally of favorable lease rights, prescription files, software, trade name and goodwill, representing the excess of the purchase price over the fair value of net assets acquired, including intangible assets.

Restructuring reserves. At the end of 1999, the consolidated balance sheet included reserves totaling \$86 million which are included as a component of Accounts payable and accrued expenses and \$25 million in Other assets. These reserves consist principally of the present value of future lease obligations for closed department stores and drugstores. Reserve balances were established based upon estimated costs to exit the properties. Actual costs were below the original estimates for certain closed stores. Consequently, reserves were adjusted in the fourth quarters of 1999 and 1998, resulting in pre-tax credits of \$12 million and \$22 million, respectively. Reserve balances were reduced by \$12 million in 1999 for cash payments made during the year. Also, in connection with the Company's 1997 early retirement program, reserves were established for the periodic future payments to be made under the Company's pension plans. These reserves are included in pension liabilities that are discussed in Note 13 to the consolidated financial statements, Retirement Plans, on page 35. Payments for both lease obligations and pension benefits will be paid out over an extended period of time. See Note 15, Restructuring Reserves, on page 37 for additional information.

Debt to capital

	1999	1998	1997
Debt to capital percent	54.3%	62.9%*	60.7%

* Upon completion of the Genovese acquisition, the debt to capital ratio declined to 62.1 percent.

Total debt, including the present value of operating leases, was \$8,602 million at the end of 1999 compared with \$12,044 million at the end of 1998 and \$11,237 million in 1997. In December 1999, the Company received \$3.2 billion in proceeds from the sale of its proprietary credit card receivables. Proceeds from the sale were used to pay down short-term debt and the balance was invested in short-term investments, pending the maturity of long-term debt issues. In conjunction with the sale, GE Capital also assumed \$729 million, including \$79 million of off-balance-sheet debt. Also during 1999, the Company retired \$225 million of long-term debt at the normal maturity date and redeemed \$199 million of Eckerd Notes due 2004.

During the fourth quarter of 1998, JCP Receivables, Inc., an indirect wholly owned subsidiary of the Company, completed a public offering of \$650 million aggregate principal amount of 5.5 percent Series E asset-backed securities of the JCP Master Credit Card Trust. In addition, the Company retired \$449 million of debt at the normal maturity date during the year, including the debt associated with the Company's ESOP.

In 1997's first quarter, the Company issued \$3.0 billion of long-term debt, which principally represented a conversion of short-term debt that had been issued in 1996 in connection with the initial phase of the Eckerd acquisition. The average effective interest rate on the debt issued in 1997 was 7.5 percent and the average maturity was 30 years.

During the past three years, the Company has issued 32.8 million shares of common stock related to its drugstore acquisitions. The Company repurchased five million shares of its common stock in the fourth quarter of 1998 for \$270 million as part of previously approved share repurchase programs. The Company has the authority to repurchase an additional five million shares under these programs.

Dividends. In December 1999, the Company reduced the quarterly dividend rate from the previous rate of \$0.545 per share to \$0.2875 per share. The change was effective for the dividend payable February 1, 2000 to stockholders of record at the close of business on January 10, 2000. In determining this dividend rate, the Company considered the overall

performance of its several businesses and the need to reinvest earnings in those businesses. It also took into account, on a preliminary basis, the potential balance sheet and financial reporting implications of creating a tracking stock for the higher-growth Eckerd drugstore operation as discussed below.

Tracking stock. In May 1999, the Company announced a tracking stock initiative that would create a separate class of stock that will reflect the performance of Eckerd drugstores and another class of stock that will reflect the performance of Department stores and catalog and Direct Marketing. The Company currently anticipates that, subject to performance and market conditions, the initial public offering of approximately 20 percent of the Eckerd tracking stock will take place during the third or fourth quarter 2000.

Economic value added (EVA®). The Company uses the principles of EVA as a tool to evaluate potential investments and other financing opportunities. The year-to-year change in EVA is used as a component in calculating amounts to be paid under selected management incentive compensation plans. Beginning in 2000, EVA measurements will be used as a component in all incentive compensation plans.

Year 2000 readiness. The Year 2000 issue existed because many computer systems store and process dates using only the last two digits of the year. Such systems, if not changed, could have interpreted "00" as "1900" instead of the year "2000." The Company began working to identify and address Year 2000 issues in January 1995. The scope of this effort included internally developed information technology systems, purchased and leased software, embedded systems and electronic data interchange transaction processing.

The Company did not experience any significant disruptions to its operations. Based on operations since January 1, 2000, the Company does not expect any significant impact to its ongoing business as a result of the Year 2000 date change. However, it is possible that the full impact of the date change has not been fully recognized. The Company believes that any such problems, however, are likely to be minor and correctable. In addition, the Company could still be negatively affected if its customers or suppliers are adversely affected by the Year 2000 or similar issues. The Company currently is not aware of any significant Year 2000 or similar problems that have arisen for its customers or suppliers. Total costs for Year 2000

remediation were \$51 million, \$19 million of which was incurred in fiscal 1999, and did not have a material impact on the Company's financial results.

Inflation and changing prices. Inflation and changing prices have not had a significant impact on the Company in recent years due to low levels of inflation.

Subsequent event. In February 2000, the Company announced that it was evaluating underperforming assets and as a result, expected to close 40 to 45 department stores and 289 drugstores. The majority of department store closings are expected to occur by July 1, 2000, while the majority of drugstore closings are expected to occur by May 1, 2000. Charges associated with department store closings are expected to total approximately \$125 million and charges associated with drugstore closings are expected to total approximately \$200 million, including inventory liquidation costs and store operating costs during the shut-down period of approximately \$80 million which will be reported within drugstore segment results. Exit costs are expected to consist principally of the write-off of asset values, the present value of future lease obligations, and severance and outplacement costs. In addition, the Company expects to finalize other cost saving initiatives that will result in a first quarter 2000 charge of \$16 million.

Company Statement on Financial Information

The Company is responsible for the information presented in this Annual Report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and present fairly, in all material respects, the Company's results of operations, financial position, and cash flows. Certain amounts included in the consolidated financial statements are estimated based on currently available information and judgment as to the outcome of future conditions and circumstances. Financial information elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

The Company's system of internal controls is supported by written policies and procedures and supplemented by a staff of internal auditors. This system is designed to provide reasonable assurance, at suitable costs, that assets are safeguarded and that transactions are executed in accordance with appropriate authorization and are recorded and reported properly. The system is continually reviewed, evaluated and where appropriate, modified to accommodate current conditions. Emphasis is placed on the careful selection, training and development of professional managers.

An organizational alignment that is premised upon appropriate delegation of authority and division of responsibility is fundamental to this system. Communication programs are aimed at assuring that established policies and procedures are disseminated and understood throughout the Company.

The consolidated financial statements have been audited by independent auditors whose report appears below. Their audit was conducted in accordance with generally accepted auditing standards, which include the consideration of the Company's internal controls to the extent necessary to form an independent opinion on the consolidated financial statements prepared by management.

The Audit Committee of the Board of Directors is composed solely of directors who are not officers or employees of the Company. The Audit Committee's responsibilities include recommending to the Board for stockholder approval the independent auditors for the annual audit of the Company's consolidated financial statements. The Committee also reviews the independent auditors' audit strategy and plan, scope, fees, audit results, and non-audit services and related fees; internal audit reports on the adequacy of internal controls; the Company's ethics program; status of significant legal matters; the scope of the internal auditors' plans and budget and results of their audits; and the effectiveness of the Company's program for correcting audit findings. The independent auditors and Company personnel, including internal auditors, meet periodically with the Audit Committee to discuss auditing and financial reporting matters.



Donald A. McKay
Executive Vice President and Chief Financial Officer

Independent Auditors' Report

To the Stockholders and Board of Directors
of J. C. Penney Company, Inc.:

We have audited the accompanying consolidated balance sheets of J. C. Penney Company, Inc. and Subsidiaries as of January 29, 2000 and January 30, 1999, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended January 29, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the

financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of J. C. Penney Company, Inc. and Subsidiaries as of January 29, 2000 and January 30, 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended January 29, 2000, in conformity with generally accepted accounting principles.

KPMG LLP

KPMG LLP
Dallas, Texas
February 24, 2000

Consolidated Statements of Income

J. C. PENNEY COMPANY, INC. AND SUBSIDIARIES

(\$ in millions)	1999	1998	1997
Revenue			
Retail sales, net	\$ 31,391	\$ 29,439	\$ 29,482
Direct Marketing revenue	1,119	1,022	928
Total revenue	32,510	30,461	30,410
Costs and expenses			
Cost of goods sold	23,374	21,642	21,294
Selling, general, and administrative expenses	7,164	6,623	6,566
Costs and expenses of Direct Marketing	872	785	711
Real estate and other	(28)	(26)	(39)
Net interest expense and credit operations	299	391	457
Acquisition amortization	129	113	117
Other charges and credits, net	169	(22)	379
Total costs and expenses	31,979	29,506	29,485
Income before income taxes	531	955	925
Income taxes	195	361	359
Net income	\$ 336	\$ 594	\$ 566

Earnings per common share

(in millions, except per share data)	Income	Average Shares	EPS
1999			
Net income	\$ 336		
Less: preferred stock dividends	(36)		
Basic EPS	300	259	\$ 1.16
Stock options and convertible preferred stock	36	16	
Diluted EPS	\$ 336	275	\$ 1.16 ⁽¹⁾
1998			
Net income	\$ 594		
Less: preferred stock dividends	(38)		
Basic EPS	556	253	\$ 2.20
Stock options and convertible preferred stock	37	18	
Diluted EPS	\$ 593	271	\$ 2.19
1997			
Net income	\$ 566		
Less: preferred stock dividends	(40)		
Basic EPS	526	247	\$ 2.13
Stock options and convertible preferred stock	36	21	
Diluted EPS	\$ 562	268	\$ 2.10

(1) Calculation excludes the effects of the potential conversion of outstanding preferred shares into common shares, and related dividends, because their inclusion would have an anti-dilutive effect on EPS.

See Notes to the Consolidated Financial Statements on pages 29 through 40.

Consolidated Balance Sheets

J. C. PENNEY COMPANY, INC. AND SUBSIDIARIES

(\$ in millions)	1999	1998
Assets		
Current assets		
Cash (including short-term investments of \$1,233 and \$95)	\$ 1,233	\$ 96
Retained interest in JCP Master Credit Card Trust	—	415
Receivables, net (bad debt reserve of \$20 and \$149)	1,138	4,268
Merchandise inventory (including LIFO reserves of \$270 and \$227)	5,947	6,060
Prepaid expenses	154	168
Total current assets	8,472	11,007
Property and equipment		
Land and buildings	3,089	3,109
Furniture and fixtures	3,955	4,045
Leasehold improvements	1,151	1,179
Accumulated depreciation	(2,883)	(2,875)
Property and equipment, net	5,312	5,458
Investments, principally held by Direct Marketing	1,827	1,961
Deferred policy acquisition costs	929	847
Goodwill and other intangible assets, net (accumulated amortization of \$340 and \$227)	3,056	2,941
Other assets	1,292	1,294
Total Assets	\$ 20,888	\$ 23,508

Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable and accrued expenses	\$ 3,351	\$ 3,443
Short-term debt	330	1,924
Current maturities of long-term debt	625	438
Deferred taxes	159	107
Total current liabilities	4,465	5,912
Long-term debt	5,844	7,143
Deferred taxes	1,461	1,512
Insurance policy and claims reserves	1,017	946
Other liabilities	873	893
Total Liabilities	13,660	16,406
Stockholders' Equity		
Preferred stock authorized, 25 million shares; issued and outstanding, 0.7 million and 0.8 million shares Series B ESDP convertible preferred	446	475
Common stock, par value 50 cents; authorized, 1,250 million shares; issued and outstanding 261 million and 250 million shares	3,266	2,850
Reinvested earnings	3,590	3,791
Accumulated other comprehensive income/(loss)	(74)	(14)
Total Stockholders' Equity	7,228	7,102
Total Liabilities and Stockholders' Equity	\$ 20,888	\$ 23,508

See Notes to the Consolidated Financial Statements on pages 29 through 40.

Consolidated Statements of Stockholders' Equity

J. C. PENNEY COMPANY, INC. AND SUBSIDIARIES

(\$ in millions)	Common Stock	Preferred Stock	Guaranteed LESOP Obligation	Reinvested Earnings	Accumulated Other Comprehensive Income/(Loss) ⁽¹⁾	Total Stockholders' Equity
January 25, 1997	\$ 1,416	\$ 568	\$ (142)	\$ 4,006⁽²⁾	\$ 37	\$ 5,885
Net income	—	—	—	566	—	566
Net unrealized change in investments	—	—	—	—	14	14
Currency translation adjustments	—	—	—	—	(3)	(3)
Total comprehensive income	—	—	—	566	11	577
Dividends declared	—	—	—	(573)	—	(573)
Common stock issued	1,350	—	—	—	—	1,350
Preferred stock retired	—	(42)	—	—	—	(42)
LESOP payment	—	—	93	—	—	93
January 31, 1998	2,766	526	(49)	3,999	48	7,290
Net income	—	—	—	594	—	594
Net unrealized change in investments	—	—	—	—	(1)	(1)
Currency translation adjustments	—	—	—	—	(61) ⁽³⁾	(61)
Total comprehensive income/(loss)	—	—	—	594	(62)	532
Dividends declared	—	—	—	(588)	—	(588)
Common stock issued	140	—	—	—	—	140
Common stock retired	(56)	—	—	(214)	—	(270)
Preferred stock retired	—	(51)	—	—	—	(51)
LESOP payment	—	—	49	—	—	49
January 30, 1999	2,850	475	—	3,791	(14)	7,102
Net income	—	—	—	336	—	336
Net unrealized change in investments	—	—	—	—	(76)	(76)
Currency translation adjustments	—	—	—	—	16	16
Total comprehensive income/(loss)	—	—	—	336	(60)	276
Dividends declared	—	—	—	(537)	—	(537)
Common stock issued	416	—	—	—	—	416
Preferred stock retired	—	(29)	—	—	—	(29)
January 29, 2000	\$ 3,266	\$ 446	\$ —	\$ 3,590	\$ (74)	\$ 7,228

(1) Cumulative net unrealized changes in investments are shown net of deferred taxes of \$(5) million, \$36 million, and \$39 million in 1999, 1998 and 1997, respectively. A deferred tax asset has not been established for currency translation adjustments.

(2) Beginning reinvested earnings has been reduced by \$67 million, net of tax, to reflect changes to certain revenue recognition policies.

(3) 1998 currency translation adjustments include \$(43) million associated with assets acquired and liabilities assumed in the purchase of Renner.

See Notes to the Consolidated Financial Statements on pages 29 through 40.

Consolidated Statements of Cash Flows

J. C. PENNEY COMPANY, INC. AND SUBSIDIARIES

(\$ in millions)	1999	1998	1997
Operating Activities			
Net income	\$ 336	\$ 594	\$ 566
Gain on the sale of business units	—	—	(52)
Other charges and credits, net	169	(22)	371
Depreciation and amortization, including intangible assets	710	637	584
Deferred taxes	(11)	219	1
Change in cash from:			
Customer receivables	13	258	215
Other receivables	(134)	(163)	(94)
Inventory, net of trade payables	169	64	(395)
Current taxes payable	(97)	(171)	116
Other assets and liabilities, net	103	(358)	(94)
	1,258	1,058	1,218
Investing Activities			
Capital expenditures	(631)	(744)	(824)
Proceeds from the sale of assets	3,179	—	276
Acquisitions ⁽¹⁾	—	(247)	—
Purchases of investment securities	(860)	(611)	(401)
Proceeds from the sale of investment securities	874	447	252
	2,562	(1,155)	(697)
Financing Activities			
Change in short-term debt	(1,650)	507	(2,533)
Proceeds from the issuance of long-term debt	—	644	2,990
Payment of long-term debt	(467)	(478)	(343)
Common stock issued, net	32	89	79
Common stock purchased and retired	—	(270)	—
Dividends paid, preferred and common	(598)	(586)	(558)
	(2,683)	(94)	(365)
Net Increase/(Decrease) in Cash and Short-Term Investments	1,137	(191)	156
Cash and short-term investments at beginning of year	96	287	131
Cash and Short-Term Investments at End of Year	\$ 1,233	\$ 96	\$ 287
Supplemental Cash Flow Information			
Interest paid	\$ 673	\$ 649	\$ 571
Interest received	61	45	71
Income taxes paid	245	307	225

(1) Reflects total cash changes related to acquisitions.

Non-cash transactions: In 1999, the Company issued 9.6 million shares of common stock having a value of \$354 million to complete the acquisition of Genovese. Also in 1999, GE Capital assumed \$650 million of balance sheet debt as part of the Company's sale of proprietary credit card receivables. In 1997, the Company issued 23.2 million shares of common stock having a value of \$1.3 billion to complete the acquisition of Eckerd.

See Notes to the Consolidated Financial Statements on pages 29 through 40.

Notes to the Consolidated Financial Statements

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1 SUMMARY OF ACCOUNTING POLICIES

Basis of presentation. In 1999, after giving consideration to guidance provided by SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, the Company changed certain revenue recognition policies affecting Department stores and catalog. Changes primarily affected the reporting of sales for licensed departments and catalog orders shipped to various Company facilities for customer pickup. These changes reduced sales by \$152 million, \$217 million and \$136 million in 1999, 1998 and 1997, respectively, and resulted in a \$67 million reduction of reinvested earnings, net of tax, as of January 28, 1995. The impact on earnings and cash flows for the intervening periods presented in this report is not material. Accordingly, the cumulative effects of the changes have been reflected as a \$20 million pre-tax charge to cost of goods sold in the statement of income for fiscal 1999, the period in which the change was made.

Third-party credit fees of \$91 million in 1999 and \$93 million in both 1998 and 1997 have been reclassified from Net interest expense and credit operations to Department stores and catalog SG&A expenses to reflect these costs as operating expenses. Certain other prior year amounts have been reclassified to conform to the current year presentation.

Basis of consolidation. The consolidated financial statements present the results of J. C. Penney Company, Inc. and its subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Definition of fiscal year. The Company's fiscal year ends on the last Saturday in January. Fiscal 1999 ended January 29, 2000; fiscal 1998 ended January 30, 1999; and fiscal 1997 ended January 31, 1998. Fiscal 1999 and 1998 were 52-week years; fiscal 1997 was a 53-week year. The accounts of Direct Marketing and Renner are on a calendar-year basis.

Revenue recognition. Retail sales include merchandise and services, net of returns, and exclude all taxes. Commissions earned on sales generated by licensed departments are included as a component of retail sales; layaway sales and catalog orders delivered to catalog departments located in department stores and other Company facilities are recorded as sales at the time customers pick up the merchandise. An allowance has been established to provide for projected merchandise returns.

Insurance premiums are recognized according to the type of product sold. Revenue is recognized for life insurance when

premiums become due and for credit, accident and health insurance over the coverage period. Premiums earned but not paid within 90 days are reversed.

Membership services revenue is recognized over the contract period, less amounts subject to money back guarantees, if any.

Earnings per common share. Basic earnings per share are computed by dividing net income less dividend requirements on the Series B ESOP Convertible Preferred Stock, net of tax, by the weighted average common stock outstanding. Diluted earnings per share assume the exercise of stock options and the conversion of the Series B ESOP Convertible Preferred Stock into the Company's common stock.

Cash and short-term investments. The Company's short-term investments are comprised principally of commercial paper which has a maturity at the acquisition date of less than three months. All other securities are classified as investments on the consolidated balance sheet.

Merchandise inventory. Substantially all merchandise inventory is valued at the lower of cost (last-in, first-out) or market, determined by the retail method. The Company determines the lower of cost or market on an aggregated basis for similar types of merchandise. The Company applies internally developed indices to measure increases and decreases in its own retail prices.

Depreciation and amortization. All long-lived assets are amortized on a straight-line basis over their respective estimated useful lives. The primary useful life for buildings is 50 years, and ranges between three and 20 years for furniture and equipment. Improvements to leased premises are amortized over the expected term of the lease or their estimated useful lives, whichever is shorter. Intangible assets, other than trade name, are amortized over periods ranging from five to seven years. Trade name and goodwill are generally amortized over 40 years.

Asset recoverability. The Company assesses the recoverability of asset values, including goodwill and other intangible assets, on a periodic basis by comparing undiscounted cash flows to carrying value. Impaired assets are written down to estimated fair value. Fair value is generally determined based on discounted expected future cash flows.

Deferred charges. Deferred policy acquisition and advertising costs, principally solicitation and marketing costs and commissions, incurred by Direct Marketing to secure new business, are amortized over the expected premium-paying period of the related policies and over the expected period of benefits for membership.

Capitalized software costs. Expenses associated with the acquisition or development of software for internal use are capitalized and amortized over the expected useful life of the software. The amortization period generally ranges between three and ten years.

Investments. The Company's investments, the majority of which are held by Direct Marketing, are classified as available-for-sale and are carried at fair value. Changes in unrealized gains and losses are included in other comprehensive income net of applicable income taxes. Realized gains and losses are determined on a first-in, first-out basis.

Insurance policy and claims reserves. Liabilities established by Direct Marketing for future policy benefits are computed using a net level premium method including assumptions as to investment yields, mortality, morbidity, and persistency based on the Company's experience. The liability for claims includes estimated unpaid claims that have been reported to the Company and claims incurred but not yet reported.

Advertising. Costs for newspaper, television, radio, and other media advertising are expensed as incurred. Catalog book preparation and printing costs, which are considered direct response advertising, are charged to expense over the life of the catalog, not to exceed six months.

Pre-opening expenses. Costs associated with the opening of new stores are expensed in the period incurred.

Foreign currency translation. Foreign currency assets and liabilities are translated into U.S. dollars at the exchange rates in effect at the balance sheet date and revenues and expenses are translated using average currency rates during the reporting period.

Derivative financial instruments. The Company selectively uses non-leveraged, off-balance-sheet derivative instruments to manage its market and interest rate risk, and does not hold derivative positions for trading purposes. The current derivative position consists of one non-leveraged, off-balance-sheet interest rate swap which is accounted for by recording the net interest received or paid as an adjustment to interest expense on a current basis. Gains or losses resulting from market movements are not recognized.

Use of estimates. The preparation of the Company's consolidated financial statements in conformity with generally accepted accounting principles requires that management estimate certain amounts that are reported. Actual results may differ from these estimates.

New accounting rules. The Financial Accounting Standards Board issued FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, in June 1998. The new rules are effective for quarters beginning after June 15, 2000. The Company has a limited exposure to derivative products and does not expect these new rules to have a material impact on reported results.

2 | ACQUISITIONS AND SALE OF RECEIVABLES

On December 6, 1999, the Company completed the sale of its proprietary credit card receivables, including its Retained Interest in the JCP Master Credit Card Trust and its credit facilities, to GE Capital. The total value of the transaction, including \$729 million of debt, \$79 million of which was off-balance-sheet debt, assumed by GE Capital, related to previous receivable securitization transactions, was \$4.0 billion. Proceeds from the sale were used to pay down short-term debt with the balance invested in short-term investments pending the maturity of long-term debt issues. The sale resulted in a pre-tax gain of \$55 million, net of an allowance for final settlement, which is included as a component of Other charges and credits, net, in the consolidated statement of income. As a part of the overall transaction, the Company also outsourced the management of its proprietary credit card business to GE Capital.

The Company has completed several acquisitions in recent years as noted below. In all cases, the purchase price was allocated to assets acquired and liabilities assumed based on estimated fair values. The excess of the purchase price over the fair value of assets acquired, including intangible assets, and liabilities assumed is accounted for as goodwill and is generally amortized over 40 years. All acquisitions have been accounted for under the purchase method. Accordingly, their results of operations are included in the Company's statements of income as of the date of the acquisition.

On March 1, 1999, the Company completed the acquisition of Genovese, a 141-drugstore chain with locations in New York, New Jersey and Connecticut. The acquisition was accomplished through the exchange of approximately 9.6 million shares of JCPenney common stock for the outstanding shares of Genovese, and the conversion of outstanding Genovese stock options into approximately 550 thousand common stock options of the Company. The total value of the transaction, including the assumption of \$60 million of debt, was \$414 million, of which \$263 million represented goodwill.

The Company completed the acquisition of a majority interest in Renner, a 21-store Brazilian department store chain, in

January 1999. The total purchase price was \$139 million, of which \$67 million represented goodwill.

During fiscal 1998, Direct Marketing formed Quest Membership Services, Inc. and acquired Insurance Consultants, Inc., strengthening its access to other business relationships. The total purchase price was approximately \$72 million, of which \$53 million represented goodwill.

3 RETAINED INTEREST IN JCP MASTER CREDIT CARD TRUST

The Company previously transferred portions of its customer receivables to a trust which, in turn, sold certificates in public offerings representing undivided interests in the trust. The Company owned the remaining undivided interest not represented by the certificates. The retained interest in the trust was transferred to GE Capital as part of the sale of the Company's credit card receivables in the fourth quarter of 1999.

The retained interest in the trust was accounted for as an investment in accordance with FAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The carrying value of \$415 million at the end of 1998 included a valuation reserve of \$15 million.

4 INVESTMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

(\$ in millions)	1999		1998	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Fixed income securities	\$ 1,433	\$ 1,396	\$ 1,269	\$ 1,322
Asset-backed certificates	267	268	431	449
Equity securities	143	163	159	190
Total	\$ 1,843	\$ 1,827	\$ 1,859	\$ 1,961

Investments. The Company's investments are recorded at fair value based on quoted market prices and consist principally of fixed income and equity securities, substantially all of which are held by Direct Marketing, and asset-backed certificates. The majority of the fixed income securities mature during the next ten years.

Financial liabilities. Financial liabilities are carried in the consolidated balance sheets at historical cost. At January 29, 2000, long-term debt, including current maturities, had a

carrying value of \$6.4 billion and a fair value of \$5.9 billion, and at January 30, 1999, had a carrying value of \$7.5 billion and a fair value of \$7.8 billion. Carrying value approximates fair value for short-term debt. These values are not necessarily indicative of actual market transactions. The fair value of long-term debt, excluding capital leases, is based on the interest rate environment and the Company's credit ratings. All long-term debt is fixed rate debt and therefore the Company is not exposed to fluctuations in market rates except to the extent described in the following paragraph.

Derivative financial instruments. The Company's current derivative position consists of one interest rate swap, with a notional principal amount of \$375 million, which was entered into in connection with the issuance of asset-backed certificates with the same principal amount. The purpose of the swap was to lock in a fixed rate of interest over the life of the financing. Both the swap and the asset-backed certificates will mature June 15, 2000. The Company's total exposure resulting from the swap is not material. The cost associated with this swap is recorded as interest expense.

Concentrations of credit risk. The Company has no significant concentrations of credit risk.

5 ACCOUNTS PAYABLE AND ACCRUED EXPENSES

(\$ in millions)	1999	1998
Trade payables	\$ 1,480	\$ 1,471
Accrued salaries, vacation, and bonus	463	444
Taxes payable	179	232
Interest payable	155	165
Workers' compensation and general liability insurance	90	77
Common dividends payable	79	140
Other ⁽¹⁾	905	914
Total	\$ 3,351	\$ 3,443

⁽¹⁾ Includes \$86 million and \$110 million for 1999 and 1998, respectively, related to other charges and credits, net, principally future lease obligations.

6 SHORT-TERM DEBT

(\$ in millions)	1999	1998
Commercial paper	\$ 330	\$ 1,924
Average interest rate at year-end	6.3%	5.1%

The decline in short-term debt as of the end of 1999 is the result of paying down commercial paper balances with the proceeds from the sale of the Company's proprietary credit card receivables in December 1999. Committed bank credit facilities available to the Company as of January 29, 2000 totaled \$3.0 billion. The facilities, as amended and restated in 1999, support the Company's short-term borrowing program and are comprised of a \$1.5 billion, 364-day revolver (expires September 29, 2000) and a \$1.5 billion, five-year revolver (expires November 21, 2002). None of the borrowing facilities was in use as of January 29, 2000.

The Company also has \$1 billion of uncommitted credit lines in the form of letters of credit with seven banks to support its direct import merchandise program. As of January 29, 2000, \$404 million of letters of credit issued by the Company were outstanding.

7 | LONG-TERM DEBT

(\$ in millions)	Jan. 29, 2000		Jan. 30, 1999	
	Avg. Rate	Balance	Avg. Rate	Balance
Notes and debentures				
Due: Year 1	6.7%	\$ 625	8.0%	\$ 424
Year 2	9.1%	250	6.7%	625
Year 3	7.5%	1,100	9.1%	250
Year 4	6.3%	350	7.5%	1,100
Year 5	7.5%	300	5.8%	1,000
Years 6 – 10	8.2%	1,172	8.0%	1,441
Years 11 – 15	9.0%	117	9.0%	125
Years 16 – 20	7.6%	763	7.6%	767
Years 21 – 30	7.5%	862	7.5%	875
Thereafter	7.5%	900	7.5%	900
Total notes and debentures	7.6%	6,439	7.4%	7,507
Capital lease obligations and other	—	30	—	74
Less current maturities	—	(625)	—	(438)
Total long-term debt	—	\$ 5,844	—	\$ 7,143

All notes and debentures have similar characteristics regardless of due date and therefore are grouped by maturity date in the above schedule.

In the first quarter of 1999, the Company redeemed approximately \$199 million principal amount of Eckerd Notes, due 2004, having a coupon rate of 9.25 percent. The Company recognized a pre-tax gain of \$5 million on the early

extinguishment of the Notes which is classified as a component of Net interest expense and credit operations in the consolidated statements of income. In the fourth quarter of 1999, GE Capital assumed \$650 million of debt, described below, in conjunction with the purchase of the Company's proprietary credit card receivables. During 1998, JCP Receivables, Inc., an indirect wholly owned subsidiary of the Company, completed a public offering of \$650 million aggregate principal amount of Series E asset-backed certificates of JCP Master Credit Card Trust. The certificates had a maturity of five years and an interest rate of 5.5 percent. The transaction did not meet the criteria for sale accounting under FAS No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and accordingly was accounted for as a secured borrowing.

8 | CAPITAL STOCK

At January 29, 2000, there were approximately 55 thousand stockholders of record. On a combined basis, the Company's savings plans, including the Company's employee stock ownership plan (ESOP), held 46.5 million shares of common stock or 16.8 percent of the Company's common shares after giving effect to the conversion of preferred stock.

Common stock. The Company has authorized 1,250 million shares, par value \$.50; 261 million shares were issued and outstanding as of January 29, 2000, and 250 million shares were issued and outstanding as of January 30, 1999.

Preferred stock. The Company has authorized 25 million shares; 743 thousand shares of Series B ESOP Convertible Preferred Stock were issued and outstanding as of January 29, 2000, and 792 thousand shares were issued and outstanding as of January 30, 1999. Each share is convertible into 20 shares of the Company's common stock at a guaranteed minimum price of \$30 per common share. Dividends are cumulative and are payable semi-annually at a rate of \$2.37 per common share equivalent, a yield of 7.9 percent. Shares may be redeemed at the option of the Company or the ESOP under certain circumstances. The redemption price may be satisfied in cash or common stock or a combination of both, at the Company's sole discretion.

Preferred stock purchase rights. In March 1999, the Board of Directors declared a dividend distribution of one preferred stock purchase right on each outstanding share of common stock in connection with the redemption of the Company's then existing preferred stock purchase rights program. These rights entitle the holder to purchase, for each right held, 1/1000 of a

share of Series A Junior Participating Preferred Stock at a price of \$140. The rights are exercisable by the holder upon the occurrence of certain events and are redeemable by the Company under certain circumstances as described by the rights agreement. The rights agreement contains a three-year independent director evaluation provision. This "TIDE" feature provides that a committee of the Company's independent directors will review the rights agreement at least every three years and, if they deem it appropriate, may recommend to the Board a modification or termination of the rights agreement.

9 STOCK-BASED COMPENSATION

The Company has a stock-based compensation plan which was approved by stockholders in 1997. The plan reserved 14 million shares of common stock for issuance to plan participants upon the exercise of options over the ten-year term of the plan. Approximately 2,000 employees, comprised principally of selected management employees, are eligible to participate. Both the number of shares and the exercise price, which is based on the average market price, are fixed at the date of grant and have a maximum term of ten years. The plan also provides for grants of stock options and stock awards to outside members of the Board of Directors. Shares acquired by such

directors are not transferable until a director terminates service. The Company accounts for stock-based compensation under the provisions of APB No. 25, *Accounting for Stock Issued to Employees*. Accordingly, net income and earnings per share shown in the consolidated statements of income appearing on page 25 do not reflect any compensation cost for the Company's fixed stock options. In accordance with FAS No. 123, *Accounting for Stock-Based Compensation*, the fair value of each fixed option granted is estimated on the date of grant using the Black-Scholes option pricing model, as follows:

Option assumptions

	1999	1998	1997
Dividend yield	3.8%	3.8%	4.0%
Expected volatility	25.1%	20.5%	21.3%
Risk-free interest rate	5.5%	5.7%	6.3%
Expected option term	7 years	6 years	6 years
Fair value per share of options granted	\$ 8.41	\$ 13.66	\$ 9.76

Compensation expense recorded under FAS No. 123 would have been approximately \$40 million in 1999, \$21 million in 1998 and \$11 million in 1997, reducing earnings per share by approximately 15 cents in 1999, eight cents in 1998 and four cents in 1997.

The following table summarizes the status of the Company's fixed stock option plans for the three years ended January 29, 2000, January 30, 1999 and January 31, 1998:

Options

(shares in thousands, price is weighted average)	1999		1998		1997	
	Shares	Price	Shares	Price	Shares	Price
Outstanding at beginning of year	6,972	\$ 48	7,583	\$ 40	8,633	\$ 36
Granted	5,619	36	1,643	71	1,413	45
Exercised	(479)	23	(2,100)	36	(2,347)	30
Expired and cancelled	(280)	40	(154)	61	(116)	48
Outstanding at end of year	11,832	\$ 43	6,972	\$ 48	7,583	\$ 40
Exercisable at end of year	6,913	\$ 48	5,418	\$ 41	6,428	\$ 38

Options as of January 29, 2000

(shares in thousands, price and term are weighted averages)	Outstanding			Exercisable	
	Shares	Price	Remaining Term (Yrs.)	Shares	Price
Under \$25	27	\$ 16	5.8	27	\$ 16
\$25 - \$35	1,779	28	1.9	1,768	28
\$35 - \$45	5,897	37	8.4	1,087	42
\$45 - \$55	1,828	48	6.6	1,825	48
Over \$55	2,301	66	7.3	2,206	66
Total	11,832	\$ 43	6.9	6,913	\$ 48

10 | INTEREST EXPENSE, NET

(\$ in millions)	1999	1998	1997
Short-term debt	\$ 137	\$ 106	\$ 121
Long-term debt	536	557	527
Other, net *	(61)	(48)	(64)
Interest expense, net	\$ 612	\$ 615	\$ 584

* Includes \$34 million in both 1998 and 1997, and \$39 million in 1996 for interest income from the Company's investment in asset-backed certificates.

11 | LEASE COMMITMENTS

The Company conducts the major part of its operations from leased premises that include retail stores, catalog fulfillment centers, warehouses, offices and other facilities. Almost all leases will expire during the next 20 years; however, most leases will be renewed or replaced by leases on other premises. Rent expense for real property operating leases totaled \$667 million in 1999, \$585 million in 1998, and \$541 million in 1997, including contingent rent, based on sales, of \$64 million, \$66 million and \$72 million for the three years, respectively.

The Company also leases data processing equipment and other personal property under operating leases of primarily three to five years. Rent expense for personal property leases was \$127 million in 1999, \$123 million in 1998, and \$126 million in 1997.

Future minimum lease payments for non-cancelable operating and capital leases, net of executory costs, principally real estate taxes, maintenance and insurance, and subleases, as of January 29, 2000 were:

(\$ in millions)	Operating	Capital
2000	\$ 620	\$ 10
2001	568	10
2002	521	6
2003	492	1
2004	454	—
Thereafter	3,099	—
Total minimum lease payments	\$ 5,754	\$ 27
Present value	\$ 3,302	\$ 24
Weighted average interest rate	9.7%	10.0%

12 | ADVERTISING COSTS

Advertising costs consist principally of newspaper, television, radio and catalog book costs. In 1999, the total cost of advertising was \$1,054 million compared with \$1,077 million in 1998, and \$977 million in 1997. The consolidated balance sheets include deferred advertising costs, primarily catalog book costs, of \$84 million as of January 29, 2000, and \$87 million as of January 30, 1999, classified as Other Assets.

13 | RETIREMENT PLANS

The Company's retirement plans consist principally of a noncontributory pension plan, noncontributory supplemental retirement and deferred compensation plans for certain management associates, a contributory medical and dental plan, and a 401(k) plan and employee stock ownership plan. In 1998, the Company adopted two additional non-qualified savings plans. Pension plan assets are invested in a balanced portfolio of equity and debt securities managed by third party investment managers. In addition to the above, Eckerd has a noncontributory pension plan. As of January 1, 1999, all Eckerd retirement benefit plans were frozen and employees began to accrue benefits under the Company's retirement plans. The cost of these programs and the December 31 balances of plan assets and obligations are shown below:

Expense

(\$ in millions)	1999	1998	1997
Pension and health care			
Service cost	\$ 109	\$ 76	\$ 68
Interest cost	220	221	200
Projected return on assets	(314)	(283)	(488)
Net amortization	13	14	248
Total pension and health care	28	28	28
Savings plan expense	35	76	71
Total retirement plans	\$ 63	\$ 104	\$ 99

Assumptions

	1999	1998	1997
Discount rate	7.75%	6.75%	7.25%
Expected return on assets	9.5%	9.5%	9.5%
Salary progression rate	4.0%	4.0%	4.0%
Health care trend rate	7.0%	7.0%	7.0%

ASSETS AND OBLIGATIONS

Pension Plans*

(\$ in millions)	1999	1998
Projected benefit obligation		
Beginning of year	\$ 3,006	\$ 2,749
Service and interest cost	303	273
Actuarial (gain)/loss	(375)	184
Benefits paid	(201)	(200)
Amendments and other	4	—
End of year	2,737	3,006
Fair value of plan assets		
Beginning of year	3,393	3,064
Company contributions	35	32
Net gains	560	497
Benefits paid	(201)	(200)
Amendments and other	4	—
End of year	3,791	3,393
Excess of fair value over projected benefits	1,054	387
Unrecognized gains and prior service cost	(563)	75
Prepaid pension cost	\$ 491	\$ 462

* Includes supplemental retirement plan.

Medical and Dental

(\$ in millions)	1999	1998
Accumulated benefit obligation	\$ 322	\$ 334
Net unrecognized losses	17	10
Net medical and dental liability	\$ 339	\$ 344

A one percent change in the health care trend rate would change the accumulated benefit obligation and expense by approximately \$26 million and \$2 million, respectively.

14

OTHER CHARGES AND CREDITS, NET

CHARGES/(CREDITS) BY CATEGORY

(\$ in millions)	1999	1998	1997
Asset impairments	\$ 240	\$ —	\$ 72
Gain on the sale of business units	(55)	—	(63)
Workforce reduction programs	—	—	206
Store closing costs	—	—	61
Drugstore integration costs	—	—	103
Other	(16)	(22)	—
Total	\$ 169	\$ (22)	\$ 379
Net income impact	\$ 126	\$ (13)	\$ 231

In 1999's fourth quarter the Company recorded items totaling \$169 million on a pre-tax basis that are reported as Other charges and credits, net. This charge was comprised of three categories: (i) asset impairment charges of \$240 million, (ii) a \$55 million gain on the sale of the Company's proprietary credit card receivables and (iii) reversal of reserves and recognition of gains, together totaling \$16 million, related to 1996 and 1997 store restructuring provisions.

Asset impairments were recognized for underperforming department stores (\$130 million) and drugstores (\$110 million) in accordance with FAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*. The impairment charges represent the excess of the carrying values of the assets, including intangible assets, over estimated fair values. The department store charge relates to ten stores, with the majority attributable to seven stores in the Washington, D.C. market that were acquired in 1995. The Washington, D.C. stores have performed substantially below levels anticipated at the time of the acquisition, and the impairment charge generally represents goodwill associated with the acquisition. Three of the impaired department stores had contracts of sale pending as of the end of fiscal 1999 and are expected to close by the end of the first quarter of 2000. Fair values for department stores were determined based on the established sales prices for the three stores, independent appraisals of three other stores and projected cash flows for the remaining stores. Stores held for sale were written down to net realizable value. Drugstore impairment charges represent the write-off of fixed

assets, including intangibles, associated with 289 underperforming stores located throughout Eckerd's operating area, with concentrations in Pennsylvania, Virginia, New Jersey and New York. The impaired stores generally represent smaller, low-volume stores that were former independent units and chains acquired over the years that do not meet Eckerd's performance standards and cannot be relocated. Subsequent to year end, a plan was approved to close all of the stores during the first half of fiscal 2000 with the majority closing by May 1. Fair values were based on projected cash flows for the expected remaining operating periods for the individual stores.

In December 1999, the Company completed the sale of its proprietary credit card receivables, including its credit facilities, to GE Capital at a gain of \$55 million (see Note 2 for further discussion of the sale). The Company also recorded credits related to restructuring charges recognized in 1996 and 1997. Gains on the sale of two closed department store locations that had been written off in 1997 totaled \$4 million

and reserves for future lease obligations were reduced by \$7 million based on the negotiation of lease terminations that were lower than the reserves that had been established in 1997. In addition, drugstore reserves were reduced by \$5 million.

In 1998's fourth quarter, the Company recorded a \$22 million pre-tax credit for the reversal of reserves established in 1997 for future obligations for store closings and workforce reduction programs. The reversals related to the final settlement of obligations for amounts less than anticipated. In 1997, the Company recorded pre-tax charges, net of \$379 million, comprised of early retirement and workforce reduction programs (\$206 million), the closing of underperforming department stores (\$133 million), drugstore integration activities (\$103 million) and gains on the sale of business units (\$63 million). Reserves for future obligations were established for certain components of the 1997 charges which are discussed in Note 15 below.

15 | RESTRUCTURING RESERVES

During 1996 and 1997, the Company established reserves for future costs associated with certain restructuring charges. These reserves were principally related to future lease obligations for both department stores and drugstores that were identified for closing. The following tables provide a roll forward of reserves that were established for these charges. Reserves are reviewed for adequacy on a periodic basis and are adjusted as appropriate based on those reviews. The following schedules, and the accompanying discussion, provide the status of the reserves as of January 29, 2000.

1997 OTHER CHARGES

(\$ in millions)	1998	1999		
	Y/E Reserve	Cash Outlays	Other Changes	Y/E Reserve
Department stores and catalog				
Future lease obligations ⁽¹⁾	\$ 20	\$ (5)	\$ (7)	\$ 8
Eckerd drugstores				
Future obligations, primarily leases ⁽¹⁾	27	(4)	—	23
Total	\$ 47	\$ (9)	\$ (7)	\$ 31

(1) Reserve balances are included as a component of Accounts payable and accrued expenses.

DEPARTMENT STORES AND CATALOG

Future lease obligations. In 1997, the Company identified 97 underperforming stores that did not meet the Company's profit objectives and several support units (credit service centers and warehouses) which were no longer needed. All of these facilities had closed by the end of fiscal 1998. The store-closing plan anticipated that the Company would remain liable for all future lease obligations. The reserve as of the end fiscal 1999 represents future lease obligations, and costs are being charged against the reserve as incurred. During fiscal 1999, approximately \$5 million in lease payments had been charged against the reserve. In the fourth quarter of 1999, reserves were reduced by \$7 million as a result of favorable lease termination settlements for certain stores.

1996 OTHER CHARGES

(\$ in millions)	1998	1999		
	Y/E Reserve	Cash Outlays	Other Changes	Y/E Reserve
Eckerd Drugstores				
Future lease obligations and severance ⁽¹⁾	\$ 59	\$ (3)	\$ (5)	\$ 51
Allowance for notes receivable ⁽²⁾	25	—	—	25
Other ⁽¹⁾	4	—	—	4
Total	\$ 88	\$ (3)	\$ (5)	\$ 80

(1) Reserve balances are included as a component of Accounts payable and accrued expenses.

(2) The allowance for notes receivable is included as a reduction of Other assets.

Future lease obligations. In 1996 the Company identified certain drugstores that would be closed in connection with its acquisition of Eckerd Corporation, and established a reserve for the present value of future lease obligations for the closed drugstores. Costs are being charged against the reserve as incurred; the interest component related to lease payments is recorded as rent expense in the period incurred with no corresponding increase in the reserve. During fiscal year 1999, approximately \$3 million in lease payments were charged against the reserve. These reserves were reviewed for adequacy in 1999, and consequently, were reduced by \$5 million.

ECKERD DRUGSTORES

Future obligations, primarily leases. During 1997, the Company established reserves for the present value of future lease payments for certain drugstores that were identified for closure. In addition, reserves were established for pending litigation and other miscellaneous charges, each individually insignificant. During fiscal 1999, approximately \$4 million in payments were charged against the reserve. On a combined basis, the reserves totaled \$23 million at the end of fiscal 1999.

Allowance for notes receivable. In connection with the Eckerd acquisition, the Federal Trade Commission required that the Company divest certain drugstores in North Carolina and South Carolina. The sale of these drugstores was partially financed by the Company through a note receivable for \$33 million. A reserve for 75 percent of the face value of the note receivable was established due to the significant constraints on the Company's ability to collect on the note.

Other. The remaining charges, the majority of which have been expensed as incurred, were related to integration activities for the Fay's drugstores acquired by the Company in October 1996, and other activities such as contract terminations.

16 | SUBSEQUENT EVENT

In February 2000, the Company announced that it was evaluating underperforming assets and as a result, expected to close 40 to 45 department stores and 289 drugstores. The majority of department store closings are expected to occur by July 1, 2000, while the majority of drugstore closings are expected to occur by May 1, 2000. Charges associated with department store closings are expected to total approximately \$125 million and charges associated with drugstore closings are expected to total approximately \$200 million, including inventory liquidation costs and store operating costs during the shut-down period of approximately \$80 million which will be reported within drugstore segment results. Exit costs are expected to consist principally of the write-off of asset values, the present value of future lease obligations, and severance and outplacement costs. In addition, the Company expects to finalize other cost saving initiatives that will result in a first quarter 2000 charge of \$16 million.

17 | TAXES

Deferred tax assets and liabilities reflected in the Company's consolidated balance sheet as of January 29, 2000 were measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The major components of deferred tax (assets)/liabilities as of January 29, 2000 and January 30, 1999 were as follows:

Temporary differences

(\$ in millions)	1999	1998
Depreciation and amortization	\$ 1,104	\$ 1,084
Leases	318	312
Deferred acquisition costs	224	233
Retirement benefits	47	49
Other, including other comprehensive income/(loss)	(73)	(59)
Total	\$ 1,620	\$ 1,619

Income tax expense

(\$ in millions)	1999	1998	1997
Current			
Federal and foreign	\$ 227	\$ 111	\$ 319
State and local	(21)	31	39
Subtotal	206	142	358
Deferred			
Federal and foreign	(5)	219	3
State and local	(6)	—	(2)
Subtotal	(11)	219	1
Total	\$ 195	\$ 361	\$ 359
Effective tax rate	36.8%	37.8%	38.8%

1999 balances include \$12 million of deferred taxes related to the Genovese acquisition.

Reconciliation of tax rates

(percent of pre-tax income)	1999	1998	1997
Federal income tax at statutory rate	35.0	35.0	35.0
State and local income taxes, less federal income tax benefit	(3.4)	2.2	2.8
Tax effect of dividends on allocated ESOP shares	(2.8)	(1.4)	(1.3)
Tax credits and other	8.0	2.0	2.3
Total	36.8	37.8	38.8

Declines in the effective tax rate over the last three years are related primarily to the effects of tax planning strategies that have significantly reduced state and local effective income tax rates.

18 | SEGMENT REPORTING

The Company operates in three business segments: Department stores and catalog, Eckerd drugstores, and Direct Marketing. The results of Department stores and catalog are combined because they generally serve the same customer, have virtually the same mix of merchandise, and the majority of catalog sales are completed in department stores. For more detailed descriptions of each business segment, including products sold, see page 2 and pages 5 through 13 of this report. Other items are shown in the table below for purposes of reconciling to total Company consolidated amounts.

(\$ in millions)	Year	Revenue	Operating Profit ⁽¹⁾	Total Assets	Capital Expenditures	Depr. & Amort.
Department stores and catalog ⁽²⁾	1999	\$ 18,964	\$ 670	\$ 10,906	\$ 321	\$ 386
	1998	19,114	920	14,433	439	380
	1997	19,819	1,275	14,850	464	366
Eckerd drugstores	1999	12,427	183	7,053	283	193
	1998	10,325	254	6,361	256	139
	1997	9,663	347	6,064	341	112
Direct Marketing	1999	1,119	247	2,842	2	2
	1998	1,022	237	2,603	1	5
	1997	928	217	2,283	5	5
Total segments	1999	32,510	1,100	20,801	606	581
	1998	30,461	1,411	23,397	696	524
	1997	30,410	1,839	23,197	810	483
Net interest expense and credit operations	1999	—	(299)	—	—	—
	1998	—	(391)	—	—	—
	1997	—	(457)	—	—	—
Real estate and other and acquisition amortization	1999	—	(101)	87	—	129
	1998	—	(87)	111	—	113
	1997	—	(78)	166	—	101
Other charges and credits, net	1999	—	(169)	—	—	—
	1998	—	22	—	—	—
	1997	—	(379)	—	—	—
Total Company	1999	32,510	531	20,888	606	710
	1998	30,461	955	23,508	696	637
	1997	30,410	925	23,363	810	584

(1) Total Company operating profit equals income before income taxes as shown on the Company's consolidated statements of income.

(2) Includes certain amounts for corporate departments.

Quarterly Data (unaudited)

J. C. PENNEY COMPANY, INC. AND SUBSIDIARIES

	First		Second		Third		Fourth	
(\$ in millions, except per share data)	1999	1998	1999	1998	1999	1998	1999	1998
Retail sales, net	\$ 7,258	\$ 6,755	\$ 7,034	\$ 6,483	\$ 7,552	\$ 7,129	\$ 9,547	\$ 9,072
Total revenue	7,532	7,001	7,310	6,734	7,834	7,381	9,834	9,345
LIFO gross margin	1,966	1,904	1,756	1,629	2,057	2,015	2,238	2,249
Net income/(loss)	167	174	39	27	142	186	(12)	207
Net income/(loss) per common share, diluted	0.61	0.64	0.12 ^m	0.08 ^m	0.51	0.68	(0.08) ^m	0.77
Dividend per common share	0.545	0.545	0.545	0.545	0.545	0.545	0.2875	0.545
Price range								
High	48.38	77.88	54.44	78.75	44.88	59.38	27.50	56.13
Low	35.38	64.69	43.75	58.00	25.31	42.63	17.69	38.13
Close	45.63	71.94	43.75	58.69	25.38	47.50	18.31	39.00

Five Year Financial Summary

J. C. PENNEY COMPANY, INC. AND SUBSIDIARIES

(In millions, except per share data)	1999	1998	1997	1996	1995
Results for the year					
Total revenue	\$ 32,510	\$ 30,461	\$ 30,410	\$ 23,292	\$ 21,084
Retail sales, net	31,391	29,439	29,482	22,474	20,404
Percent increase	6.6%	(0.1)%	31.2%	10.1%	1.5%
Net income	\$ 336	\$ 594	\$ 566	\$ 565	\$ 838
Return on beginning stockholders' equity	4.7%	8.2%	8.0% ^m	9.7%	15.1% ^m
Per common share					
Net income, diluted	\$ 1.16 ^m	\$ 2.19	\$ 2.10	\$ 2.25	\$ 3.33
Dividends	1.92	2.18	2.14	2.08	1.92
Stockholders' equity	26.17	26.74	27.31	24.71	24.60
Financial position					
Capital expenditures	606	636	810	790	749
Total assets	20,888	23,508	23,363	21,958	16,972
Long-term debt	5,844	7,143	6,986	4,565	4,080
Stockholders' equity	7,228	7,102	7,290	5,885	5,817 ^m
Other					
Common shares outstanding at end of year	261	250	251	224	224
Weighted average common shares					
Basic	259	253	247	226	226
Diluted	275	271	268	248	249
Number of employees at end of year (in thousands)	291	268	260	252	205

(1) Calculation excludes the effects of the potential conversion of outstanding preferred shares into common shares, and related dividends, because their inclusion would have an anti-dilutive effect on EPS.

(2) Assumes the completion of the Eckerd acquisition in beginning equity.

(3) Beginning reinvested earnings has been reduced by \$67 million, net of tax, to reflect changes to certain revenue recognition policies.

Five Year Operations Summary

J. C. PENNEY COMPANY, INC. AND SUBSIDIARIES

	1999	1998	1997	1996	1995
Department stores					
Number of stores — JCPenney department stores					
Beginning of year	1,148	1,203	1,228	1,238	1,233
Openings	14	12	34	36	43
Closings	(19)	(67)	(59)	(46)	(38)
End of year	1,143	1,148	1,203	1,228	1,238
Renner department stores	35	21	—	—	—
Total department stores	1,178	1,169	1,203	1,228	1,238
Gross selling space (in millions)	116.4	116.0	118.4	117.2	114.3
Sales (in millions)	\$ 15,016	\$ 15,224	\$ 15,904	\$ 15,568	\$ 14,814
Sales including catalog desks (in millions)	17,575	17,991	18,953	18,515	17,771
Sales per gross square foot	154	154	156	157	154
Catalog					
Number of catalog units					
Department stores	1,142	1,139	1,199	1,226	1,228
Freestanding sales centers and other	509	512	554	569	565
Drugstores	410	139	110	107	106
Total	2,061	1,790	1,863	1,902	1,899
Sales (in millions)	\$ 3,948	\$ 3,890	\$ 3,915	\$ 3,759	\$ 3,739
Eckerd drugstores					
Number of stores					
Beginning of year	2,756	2,778	2,699	645	526
Openings	266*	220*	199*	47	37
Acquisitions	163	36	200	2,020	97
Closings	(287)*	(278)*	(320)*	(13)	(15)
End of year	2,898	2,756	2,778	2,699	645
Gross selling space (in millions)	29.2	27.6	27.4	26.4	6.2
Sales (in millions)	\$ 12,427	\$ 10,325	\$ 9,663	\$ 3,147	\$ 1,851
Sales per gross square foot	395	350	314	261	253
Direct Marketing					
Revenue (in millions)	\$ 1,119	\$ 1,022	\$ 928	\$ 818	\$ 680
Distribution of revenue					
JCPenney customers	48%	50%	53%	56%	65%
Other business relationships	52%	50%	47%	44%	35%
Policies, certificates, and memberships in force at year end (in millions)	14.8	14.7	13.2	11.3	9.6

* Includes relocations of 208 drugstores in 1999, 175 drugstores in 1998 and 127 drugstores in 1997.

Supplemental Data (unaudited)

General. The following information is provided as a supplement to the Company's audited financial statements. Its purpose is to facilitate an understanding of credit sales penetration rates, capital structure and cash flows.

The following table presents the sales penetration rates of the Company's proprietary/private-label and third-party credit cards.

Department stores and catalog

(\$ in billions)	1999		1998		1997	
	Sales	Percent of Eligible Sales	Sales	Percent of Eligible Sales	Sales	Percent of Eligible Sales
JCPenney credit card	\$ 7.4	37.9%	\$ 7.6	39.4%	\$ 8.6	43.4%
Third-party credit cards	5.2	27.6%	5.0	26.1%	4.7	23.5%
Total	\$ 12.6	65.5%	\$ 12.6	65.5%	\$ 13.3	66.9%

EBITDA. Earnings before interest, taxes, depreciation, and amortization (EBITDA) is a key measure of cash flow generated and is provided as an alternative assessment of operating performance. It is not intended to be a substitute for GAAP measurements. Following is a calculation of EBITDA by operating segment on an individual and combined basis; calculations may vary for other companies:

(\$ in millions)	Department Stores & Catalog	Eckerd Drugstores	Direct Marketing	Total Segments
1999				
Revenue	\$ 18,964	\$ 12,427	\$ 1,119	\$ 32,510
Segment profit	670	183	247	1,100
Depreciation and amortization	386	193	2	581
Credit operating results	313	—	—	313
EBITDA	\$ 1,369	\$ 376	\$ 249	\$ 1,994
% of revenue	7.2%	3.0%	22.3%	6.1%
1998				
Revenue	\$ 19,114	\$ 10,325	\$ 1,022	\$ 30,461
Segment profit	920	254	237	1,411
Depreciation and amortization	380	139	5	524
Credit operating results	224	—	—	224
EBITDA	\$ 1,524	\$ 393	\$ 242	\$ 2,159
% of revenue	8.0%	3.8%	23.7%	7.1%
1997				
Revenue	\$ 19,819	\$ 9,663	\$ 928	\$ 30,410
Segment profit	1,275	347	217	1,839
Depreciation and amortization	366	112	5	483
Credit operating results	127	—	—	127
EBITDA	\$ 1,768	\$ 459	\$ 222	\$ 2,449
% of revenue	8.9%	4.7%	23.9%	8.0%

Capital structure. The Company's objective is to maintain a capital structure that will assure continuing access to financial markets so that it can, at reasonable cost, provide for future needs and capitalize on attractive opportunities for growth.

The debt to capital percentage shown in the table below includes both debt recorded on the Company's consolidated balance sheet as well as off-balance-sheet debt related to operating leases and the securitization of a portion of the Company's customer accounts receivable (asset-backed certificates).

Debt to capital

(\$ in millions)	1999	1998	1997
Short-term debt, net of cash investments	\$ (1,170) ⁽¹⁾	\$ 1,602	\$ 1,209
Long-term debt, including current maturities	6,469	7,581	7,435
	5,299	9,183	8,644
Off-balance-sheet debt			
Present value of operating leases	3,302	2,715	2,250
Securitization of receivables, net	—	146	343
Total debt	8,601	12,044	11,237
Consolidated equity	7,228	7,102	7,290
Total capital	\$ 15,829	\$ 19,146	\$ 18,527
Percent of total debt to capital	54.3%	62.9% ⁽²⁾	60.7%

(1) Includes asset-backed certificates of \$267 million.

(2) Upon completion of the Genovese acquisition, the Company's debt to capital percentage decreased to 62.1%.

The Company's debt to capital percentage improved in 1999 primarily as a result of the sale of the Company's proprietary credit card receivables. The Company currently expects the percentage to improve over the next several years.

Credit ratings. Ratings as of March 13, 2000 were as follows:

	Long-term Debt	Commercial Paper
Moody's Investors Service	Baa2	P2
Standard & Poor's Corporation	BBB+ ⁽¹⁾	A2 ⁽¹⁾
Fitch Investors Service, Inc.	A- ⁽¹⁾	F2

(1) Under review.

Corporate Governance

The Company is aware that many of its stockholders are interested in matters of corporate governance. JCPenney shares this interest and is, and for many years has been, committed to assuring that the Company is managed in a way that is fair to all its stockholders and which allows its stockholders to maximize the value of their investment by participating in the present and future growth of JCPenney. The Corporate Governance Committee of the Board of Directors reviews developments in the governance area as they affect relations between the Company and its stockholders and makes recommendations to the full Board regarding such issues.

Independent Board of Directors. In keeping with its long-standing practice, the Company's Board continues to be an independent board under any reasonable definition. Nominees for directors are selected by a committee composed entirely of directors who are not Company employees. The wide diversity of expertise, experience and achievements that the directors possess in business, investments, large organizations and public affairs allows the Board to most effectively represent the interests of all the Company's stockholders.

Independent committees. The Audit Committee, Benefit Plans Review Committee, Corporate Governance Committee, Personnel and Compensation Committee, and the Public Affairs Committee, all standing committees of the Board of Directors, are composed entirely of directors who are not employees of the Company. These committees, as well as the entire Board, consult with, and are advised by, outside consultants and experts in connection with their deliberations as needed.

Executive compensation. A significant portion of the cash compensation received by the Company's executive officers consists of performance incentive compensation payments derived from compensation plan "values", as well as from the Company's EVA plan. The amounts of these plan values are directly related to the sales and earnings of the Company and, consequently, vary from year to year based upon Company

performance. The total compensation package for the Company's executive officers is set by the Personnel and Compensation Committee, which is composed entirely of directors who are not employees of JCPenney and which receives the advice of independent outside consultants. Please refer to the Company's 2000 Proxy Statement for a report from the Company's Personnel and Compensation Committee describing how compensation determinations are made.

Confidential voting. The Company has a long-standing confidential voting policy. Under this policy, all proxy (voting instruction) cards, ballots and vote tabulations, including telephone voting, that identify the particular vote of a stockholder are kept secret from the Company, its directors, officers and employees. Proxy cards are returned in envelopes directly to the tabulator, who receives and tabulates the proxies. The final tabulation is inspected by inspectors of election who are independent of the Company, its directors, officers and employees. The identity and vote of a stockholder is not disclosed to the Company, its directors, officers or employees, or any third party except (i) to allow the independent election inspectors to certify the results of the vote; (ii) as necessary to meet applicable legal requirements and to assert or defend claims for or against the Company; (iii) in the event of a proxy solicitation based on an opposition proxy statement filed, or required to be filed, with the Securities and Exchange Commission; or (iv) in the event a stockholder has made a written comment on such material.

Corporate Citizenship

Community relations. The Company remains committed to investing in community programs that are important to its customers and encouraging associates to invest their talents in those communities, as well.

In 1999, JCPenney, Eckerd drugstores and Direct Marketing supported charitable organizations with grants totaling \$27.3 million, including \$3 million in donated goods and services. The majority of this support was directed to local charitable organizations in communities nationwide.

JCPenney's 1999 United Way campaign raised nearly \$17 million in associate and unit pledges for nearly 1,000 local United Way organizations nationwide. JCPenney also launched the JCPenney Afterschool initiative in September, pledging \$30 million to providing quality and affordable afterschool care to children ages 6-18.

A more complete review of JCPenney's community relations efforts is available in the "JCPenney Community Partners" report.

Eckerd is one of the top ten national sponsors of the Children's Miracle Network (CMN). All funds raised for CMN support local children's hospitals that serve children regardless of their parents' ability to pay.

Diversity. JCPenney has been a corporate member of the National Minority Supplier Development Council (NMSDC) since 1972, and continues to invest in the NMSDC's Business Consortium Fund, which makes loans to minority-owned businesses. The Company is a founding member of the Women's Business Enterprise National Council. In 1999, the Company's purchases from minority-owned and women-owned businesses totaled \$361 million and \$267 million, respectively.

Environmental affairs. Our commitment to doing business in a responsible manner includes a determination to make environmental, health, and safety considerations an important factor in corporate decision making and policy. Copies of "Matter of Principle: JCPenney and Environmental Responsibility," including the Company's statement on environmental principles, and JCPenney Community Partners may be obtained as indicated on page 47 of this report.

Other Corporate Information

EQUAL EMPLOYMENT OPPORTUNITY

	Total Employed		Percent Female		Percent Minority	
	1999	1995 *	1999	1995 *	1999	1995 *
Officials, managers, and professionals	30,611	19,346	48.4%	49.2%	18.5%	12.6%
Management trainees	506	542	77.9%	70.5%	30.8%	34.2%
Sales workers	156,581	107,329	82.2%	87.8%	28.0%	21.6%
Office and clerical workers	40,421	33,786	85.9%	88.6%	25.7%	20.9%
Technicians, craft workers, operatives, laborers, and service workers	56,435	41,354	68.7%	67.8%	32.4%	26.7%
Total	284,554	202,357	76.6%	80.1%	27.6%	21.8%

* 1995 does not include associate counts for the drugstore acquisitions.

Equal employment opportunity. The Company adheres to a policy of equal employment opportunity. The above employment information summary represents associates of J. C. Penney Company, Inc. and Subsidiaries, excluding associates in Canada, Mexico, Brazil, Puerto Rico and the United Kingdom. The information provided delineates minority and female representation in major job categories.

Supplier legal compliance. JCPenney has a comprehensive and effective program for promoting compliance with labor and other laws in the factories used by its suppliers in the United States and abroad. This program is described in The JCPenney Supplier Legal Compliance Program, which may be obtained as indicated.

Annual meeting. The Company's Annual Meeting of Stockholders will be held at 10 a.m. local time, Friday, May 19, at the Company's Catalog Fulfillment Center located at 10500 Lackman Road, Lenexa, KS 66250. You are cordially invited to attend. The Annual Report and Proxy Statement, including a request for proxies, were mailed to stockholders on or about April 14, 2000.

Stockholder investor services program. Investors may acquire shares of JCPenney common stock directly through a dividend reinvestment/direct purchase program as an alternative to broker assisted purchases. This program, which is being administered by The Chase Manhattan Bank, is available to both new and existing stockholders. The program has a minimum investment requirement of \$25 for existing stockholders and is available to new stockholders after a minimum initial investment of \$250. The program offers full or

partial dividend reinvestment as well as payment of dividends by check or electronic deposit. In addition, the program offers safekeeping of stock certificates, transfers or gifts of JCPenney shares, and the ability to sell or withdraw shares by telephone. To receive more information about this program, call 1-800-565-2576.

Financial/other information. Copies of the following are available at jcpenny.com:

- The Company's Annual Report on Form 10-K and Quarterly Reports on Form 10-Q filed with the Securities and Exchange Commission
- JCPenney Community Partners, the Company's social responsibility report

Copies of the following are available upon request:

- The Partnership Program, opportunities for minority- and women-owned businesses
- Matters of Principle: JCPenney and Environmental Responsibility
- The JCPenney Supplier Legal Compliance Program
- JCPenney Funding Corporation's Annual Report

Requests for the above should be addressed to:

J. C. Penney Company, Inc.
P. D. Box 10001
Dallas, TX 75301-4301

Board of Directors

James E. Desterreicher 6
Chairman of the Board and Chief Executive Officer

M. Anthony Burns 1,3,5,6
Chairman and Chief Executive Officer, Ryder System, Inc.

Thomas J. Englbous 2,4,6
Chairman, President, and Chief Executive Officer, Texas Instruments Incorporated

Kent B. Foster 2,4
President and Chief Executive Officer, Ingram Micro Inc.

Vernon E. Jordan, Jr. 1,2,3
Managing Partner, Lazard Freres & Co., Of Counsel, Law Firm of Akin, Gump, Strauss, Hauer & Feld, L.L.P.

Jane C. Pfeiffer 3,4,5
Independent Management Consultant

Ann W. Richards 1,2,5
Senior Advisor, Law Firm of Verner, Lipfert, Bernhard, McPherson & Hand, and Formerly Governor of Texas

Francisco Sanchez-Loaeza 1,4,6
Chairman, President and Chief Executive Officer, Panamerican Beverages, Inc.

Charles S. Sanford, Jr. 1,3,4,6
Retired Chairman and Chief Executive Officer, Bankers Trust New York Corporation and Bankers Trust Company

R. Gerald Turner 2,3,5
President, Southern Methodist University

Board Committees

1. Member of the Audit Committee of the Board of Directors. This committee recommends to the Board of Directors for stockholder approval the independent auditors for the annual audit of the Company's consolidated financial statements. The committee also reviews the independent auditors' audit strategy and plans, scope, fees, audit results of the auditors, and non-audit services and related fees; internal audit reports on the adequacy of internal accounting controls; the Company's ethics program; status of significant legal matters; the scope of the internal auditors' plans and budget and results of their audits; and the effectiveness of the Company's program for correcting audit findings.
2. Member of the Public Affairs Committee. This committee identifies, analyzes and brings to the attention of the Board social and environmental trends, community affairs and public policy issues that may have a potential impact on the business performance and investment character of the Company. It assures that Company policy and performance reflect a sensitivity toward the social and physical environments in which the Company does business and that such policy and performance are in accord with the public interest.
3. Member of the Corporate Governance Committee. This committee considers matters of corporate governance and reviews developments in the governance area as they affect relations between the Company and its stockholders.

Senior Management

James E. Desterreicher*
Chairman of the Board and Chief Executive Officer

Vanessa J. Castagna*
Executive Vice President and Chief Operating Officer for JCPenney Stores, Merchandising and Catalog

Gary L. Davis*
Executive Vice President, Chief Human Resources and Administration Officer

Gale Duff-Bloom (Retires April 2000)
President of Company Communications and Corporate Image

David V. Evans*
Senior Vice President, Chief Information Officer

John E. Feserman*
President and Chief Operating Officer, JCPenney Direct Marketing, Credit, International and Facilities Services; interim manager, drugstore operations

Thomas D. Hutchens (Retired February 2000)
President and Chief Operating Officer, International

Charles R. Lotter*
Executive Vice President, Secretary and General Counsel

Donald A. McKay*
Executive Vice President and Chief Financial Officer

Michael W. Taxter
Senior Vice President, Director of JCPenney Stores

*Member of the Company's Executive Committee

It also makes recommendations to the Board with respect to the size, composition, organization, responsibilities and functions of the Board and its directors, the qualifications of directors, candidates for election as directors and the compensation of directors.

4. Member of the Personnel and Compensation Committee. This committee reviews and administers the Company's annual and long-term incentive compensation plans, makes recommendations in areas concerning personnel relations, and takes action or makes recommendations with respect to the compensation of Company executive officers, including those who are directors.
5. Member of the Benefit Plans Review Committee. This committee reviews annually the financial condition and investment performance results of the Company's retirement plans, annual actuarial valuation reports for the Company's pension plan, and the financial condition, investment performance results and actuarial valuation aspects of the Company's welfare plans. It is also the committee that administers certain of the Company's retirement and welfare plans.
6. Member of the Finance Committee. This committee is responsible for reviewing the Company's financial policies, strategies and capital structure.

Stockholder Relations

Transfer Agent/Registrar

Inquiries about your stockholder records should be forwarded to:

Chase/Mellon Shareholder Services L.L.C.
Shareholder Relations Department
P.O. Box 3815
South Hackensack, NJ 07606
1-800-842-3470
chasemellon.com

Exchange Listing

The New York Stock Exchange
Ticker symbol: JCP

Internet Access

jcpenny.com

Sales Release Dates for Fiscal 2000

Release Date	Sales Period
March 2	February
April 6	March
May 4	April
June 1	May
July 6	June
August 3	July
August 31	August
October 5	September
November 2	October
November 30	November
January 4, 2001	December
February 1, 2001	January 2001

Earnings Release Dates for Fiscal 2000

Release Date	Quarter
May 16	1st Quarter
August 15	2nd Quarter
November 14	3rd Quarter
February 22, 2001	4th Quarter

Company updates, including press releases and weekly sales, are available by calling 972-431-5500 or by accessing our Internet site.

Security Analyst & Investment Professional Contacts

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Eli Akresh	972-431-2207	eakresh@jcpenny.com

